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Lay Summary

A penalty clause is a contractual provision which binds a party who breaches the contract to do something. A common example is a requirement to pay a sum of money. The penalty doctrine operates to protect parties in breach of contract from exorbitant sanctions. Historically, the Scots law approach has been that a clause must be a "genuine pre-estimate of loss." A clause which punished the party in breach for the breach of contract would not be enforced by the courts. In the recent English case of *Cavendish Square Holding BV* v *Makdessi* and *ParkingEye Ltd* v *Beavis*, the Supreme Court held that penalty clauses did not have to be genuine pre-estimates of loss. Instead, the penalty clause must be proportionate to the "legitimate interest" of the innocent party. Following *Cavendish*, penalty clauses which punish the party in breach are still unenforceable. A significant problem arising out of *Cavendish* is the uncertainty regarding which interests will be considered legitimate. The dissertation explores this question with reference to English cases preceding and following *Cavendish*. The dissertation identifies some factors which will be relevant to the court when deciding whether a penalty clause is protecting a legitimate interest. Although *Cavendish* is an English case, it has been considered and applied in subsequent Scottish cases. Therefore, the dissertation discusses how *Cavendish* differs from the traditional Scottish approach to the penalty doctrine.

The central question in this dissertation is whether the legitimate interest concept set out in *Cavendish* shares any characteristics with the legitimate interest concept which already exists in Scots law. This analysis is carried out with reference to (i) specific implement and (ii) a party's right to insist on providing performance after repudiation. Specific implement is a legal remedy for breach of contract. In Scots contract law, an innocent party has a legal right to insist that the party in breach performs their contractual obligations. In Scots law, an innocent party also has a legal right to provide performance even where the other party to the contract indicates through their behaviour that they do not consider themselves bound by the contract. These remedies are compared to the English equivalents which were important to the decision in *Cavendish*. Overall, it is concluded that the Scottish legitimate interest concept is fundamentally different from the English legitimate concept outlined in *Cavendish*. It is suggested this difference can be explained by the fact that Scots and English contract law have different theoretical underpinnings. In Scots contract law, an innocent party to a contract has a legal right to performance of the contractual obligations from the party in breach. In contrast, in English law, an innocent party to a contract only has a legal right to receive financial compensation for breach of contract through the remedy called damages.

The dissertation also discusses the Scottish court's power of modification. Essentially, the Scottish courts have a power to reduce excessive penalties. The dissertation

considers the way this power might be affected by *Cavendish*. Finally, the dissertation outlines some potential reforms of the penalty doctrine. The rationales for the penalty doctrine are (i) to help parties avoid the costs associated with litigation, and (ii) to protect parties from excessive stipulations. The suggested reforms aim to promote these two rationales. Firstly, to help avoid litigation, damages might be capped at the amount stipulated for by the penalty clause. This would reduce the likelihood of parties going to court by making it so they will not get a better remedy by doing so.

Secondly, it is suggested that consumers are in need of additional protections. Therefore, the dissertation suggests that the subjective characteristics of a particular consumer might be factored into the court's consideration of whether a clause is a penalty. A lower threshold might be introduced for consumers. It is also argued that the court should have the power to refuse to enforce a clause where it would cause severe hardship to the party in breach, regardless of whether the clause is proportionate to the innocent party's legitimate interest.

Abstract

The focus of this dissertation is the Supreme Court conjoined cases of *Makdessi* v *Cavendish Square Holdings BV* and *ParkingEye Ltd* v *Beavis* [2015] UKSC 67. In this English appeal, the Supreme Court introduced a new approach to penalty clauses, including the criterion of "legitimate interest". The dissertation assesses these changes to the law of penalties from a Scots law perspective. The dissertation analyses the way in which the concept of legitimate interest fits within the overall structure of remedies for breach of contract in Scots law. "Legitimate interest" is already used another part of Scots contract law: unwanted contractual performance. The dissertation also evaluates whether there is a "legitimate interest" in specific implement. The question asked is whether "legitimate interest" in the law of penalties shows any similarity to or relationship with "legitimate interest" in these other areas of Scots contract law. Thus, this dissertation contributes to scholarship not only by analysing the law of penalties from a Scottish perspective, but also assessing the wider taxonomical impact of *Cavendish* on the Scots law of contract remedies.

I argue that *Cavendish* represents a dramatic change in the Scottish approach to the penalty doctrine as it introduces a novel "legitimate interest" test to replace the previous "genuine pre-estimate of loss" test. The dissertation explores the idea of a legitimate interest, ultimately concluding that the concept is subject to an unacceptable degree of uncertainty.

Underpinning the penalty doctrine is the tension between the principles of freedom of contract and certainty on the one hand, and the courts' refusal to permit punitive damages on the other. A key aspect of the dissertation will be considering how the balance between these competing principles has shifted following *Cavendish*.

Finally, I will consider some aspects of the penalty doctrine which are currently deficient and suggest some potential avenues for reform. Specifically, I focus on reforms which would support the underlying rationales for the penalty doctrine: (1) to avoid the need for litigation, and (2) to protect parties from excessive sanctions. The suggested reforms will include capping damages to the liquidated damages clause, strengthening the penalty doctrine in relation to consumers, and developing the Scottish court's equitable jurisdiction. The Scottish court's power of modification in relation to penalties will also be evaluated, and some changes will be suggested to align it with the new legitimate interest test.

Structure

The dissertation begins by considering the status of *Cavendish* as a precedent governing penalty clauses in Scots contract law. Despite the fact that *Cavendish* is an English case and thus not formally binding on the Scottish courts, it has been followed

without question in subsequent Scottish cases. Therefore, this dissertation specifically considers *Cavendish* from a Scottish perspective and the way in which *Cavendish* affects the Scottish approach to the penalty doctrine.

Following the introductory chapter, the second chapter begins by examining the historic Scottish approach to the penalty doctrine in order to determine the pre-existing legal landscape. This chapter starts by considering the origins and justifications of the penalty doctrine, before describing its final form prior to *Cavendish*.

In the third chapter, I set out the ratio of *Cavendish*. This includes identifying the legitimate interest and proportionality aspects of the new test for the penalty doctrine. Also, I analyse the series of English cases that culminated in *Cavendish*, known as the 'commercial justification' cases. These cases were relied upon in *Cavendish*, and so they are examined in this chapter to provide context for the meaning of the legitimate interest test. The chapter analyses the way in which the new approach has been applied by the English courts post-*Cavendish*. This illustrates the way in which the courts have interpreted the legitimate interest and proportionality requirements. This analysis indicates that some common factors have been relied upon by the English courts when applying the legitimate interest test.

In the fourth chapter, I compare the orthodox Scottish approach with the approach taken in *Cavendish*. This chapter questions how significant the changes wrought by *Cavendish* will be, given that the judges in *Cavendish* aimed to ground their decision in existing Scottish precedent and stated that the previous approach to the penalty doctrine would continue to be relevant in simple cases. Despite the Supreme Court's attempts to ground the new test in existing authority, it will be argued that *Cavendish* still marks a significant shift in approach to the penalty doctrine.

The fifth chapter explores whether the idea of "legitimate interest" has a common meaning across more than one part of Scots contract law. The Supreme Court in *Cavendish* referred to the concept of a legitimate interest as it exists in both specific performance and unwanted contractual performance. I examined these areas to determine whether the idea of legitimate interest shares a common meaning across these different areas of contract law.

The first half of this chapter focuses on specific performance, which was referred to by the Supreme Court in *Cavendish* when determining when the genuine pre-estimate of loss test will continue to apply. Specific performance will be contrasted with the Scottish remedy of specific implement, and it is argued that these remedies are fundamentally different from each other. Parties in England do not have a right to specific performance, and its award is contingent on damages providing an insufficient remedy. In contrast, parties in Scotland do have a legal right to specific implement, although a court may exercise its equitable jurisdiction in order to refuse it in exceptional circumstances. As a

result, I conclude that the role played by the concept of legitimate interest in the penalty doctrine is distinct from the concepts underpinning specific implement.

The second half of chapter five focuses on anticipatory breach. This part of the chapter analyses English and Scottish cases to identify whether common factors are used to determine whether a party has a legitimate interest in the context of both unwanted contractual performance and the penalty doctrine. Ultimately, it is contended that the English cases diverged from the Scottish ones in interpreting the leading case, *White & Carter (Councils) Ltd* v *McGregor* 1962 SC (HL) 1. Nevertheless, it is suggested that there are indeed shared principles between the legitimate interest in the penalty doctrine and in unwanted contractual performance.

The sixth chapter examines the equitable jurisdiction of the Scottish courts, which is the basis for the court's power of modification. Unlike the English courts, the Scottish courts have historically possessed a power to modify penalty clauses, as well as to determine whether they are unenforceable. Despite referencing the power of modification, in *Cavendish* the Supreme Court did not provide any guidance on how the new approach might fit with this power of modification. Furthermore, the power of modification was placed partially on a statutory basis, and it is argued that this needs to be updated to reflect the changes wrought by *Cavendish*.

Overall, this dissertation has argued that there are difficulties with *Cavendish*, most notably the uncertainty over what constitutes a legitimate interest. The reference to specific performance is particularly unhelpful from a Scottish perspective, given the differences outlined between specific performance and the Scottish native remedy of specific implement. The comparison with anticipatory breach was more useful but did not provide a complete solution.

In addition to the doubt over the meaning of legitimate interest, the new approach also creates tension with the purposes of the penalty doctrine: (1) preventing the need for litigation, and (2) protecting contracting parties from exorbitant sanctions. Part of the Supreme Court's rationale for reforming the penalty doctrine in *Cavendish* was to improve certainty for contracting parties, and reduce litigation and associated transaction costs. Historically, this justified the approach of the Scottish courts in enforcing liquidated damages clauses. Consequently, it is argued that where parties have agreed upon a liquidated damages clause, this should act as a cap on the amount of damages available. This would promote the objective of reducing litigation, by ensuring parties would not waste time and money negotiating a liquidated damages clause only to pursue litigation regardless.

Finally, the drastic decrease in the scope of the penalty doctrine limits the court's ability to use it to protect parties from excessive sanctions for breach of contract. To counterbalance this, I suggested two solutions. Firstly, the court could modify its

approach to the penalty doctrine in relation to consumers. The court could take into account certain characteristics of the consumer when determining whether a clause is a penalty, such as the degree to which they were under financial pressure when making the bargain. Such factors might lead the court to find a clause is a penalty more readily than in commercial circumstances. Secondly, the court's equitable jurisdiction could be developed to empower the court to refuse enforcement of a liquidated damages clause which would cause undue hardship to the debtor.

A. CHAPTER I – INTRODUCTION

This dissertation will examine the seminal conjoined appeals of *Cavendish Square Holding BV* v *Makdessi* and *ParkingEye Ltd* v *Beavis*, which have transformed the English approach to the penalty doctrine by introducing a novel "legitimate interest" test.[1] Despite the fact that *Cavendish* is highly persuasive for Scots law, and has been considered in subsequent Scottish cases, the existing Scottish research in this area is limited.[2] This dissertation aims to redress this, by providing a critical analysis of *Cavendish* from a Scottish perspective.

The dissertation begins by exploring the Scottish approach to the penalty doctrine prior to *Cavendish*, considering its origins, rationale, and formulation. This first chapter will provide the basis for understanding how different the approach taken in *Cavendish* was compared to the orthodox Scots law conception of the penalty doctrine. The second chapter analyses *Cavendish*, discussing the English cases cited by the judges in *Cavendish* and the English cases which followed *Cavendish*. This will identify the ratio in *Cavendish*, and consider how it has been interpreted. Finally, chapter IV will offer some conclusions on the changes that will be wrought by *Cavendish*.

Chapter V will question how the legitimate interest test fits into the structure of remedies for breach of contract in Scots law. In *Cavendish*, it was argued that there were general limitations on the availability of remedies for breach of contract, which were exemplified by specific performance and a party's ability to insist on performing after repudiation.[3] It will be argued that in Scots law, the court's equitable jurisdiction is used to control the availability of remedies for breach of contract in some areas, and that there are some shared characteristics with the concept of legitimate interest as described in *Cavendish*.

The Scottish court's equitable jurisdiction will be discussed further in chapter VI. The Scottish court's power to modify penalties will be examined.[4] Given that the English courts do not have an equivalent power, this distinction represents one of the few differences between the Scottish and English approaches to the penalty doctrine prior to *Cavendish*. This distinction was identified in *Cavendish*, and this chapter will discuss the

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[1] *Cavendish Square Holding BV* v *Makdessi*; *ParkingEye Ltd* v *Beavis (Consumers' Association Intervening)* [2015] UKSC 67, [2016] AC 1172.

[2] Discussion Paper on *Penalty Clauses* (Scot Law Com No 162, 2016) para 1.7; *Gray* v *Braid Group (Holdings) Ltd* [2016] CSIH 68 at paras 106-108 per Lord Menzies; *Indigo Park Services UK Ltd* v *Watson* 2017 GWD 40-610 at para 46 per Sheriff Drummond; *ZLX Ltd* v *James Mackie Wholesale Ltd* [2024] SC GLA 38 at para 52 per Sheriff S Reid; see however B Lindsay, "Penalty Clauses in the Supreme Court: A Legitimately Interesting Decision?" (2016) 20(2) Edinburgh Law Review 204; H L MacQueen, *MacQueen and Thomson on Contract Law in Scotland,* 6th edn (2024) paras 8.48-8.51; H L MacQueen, "Contract Law Reform: Legislators or Judges – or Both?" (2021) (1) Acta Juridica 57 at 65-76; L Richardson, "Commercial Justification for Penalty Clauses: The Death of the Old Dichotomy?" (2015) 19(1) Edinburgh Law Review 119.

[3] *Cavendish* at paras 29-30 per Lords Neuberger and Sumption.

[4] *Cavendish* at para 252 per Lord Hodge.

implications of introducing the legitimate interest test in relation to the power of modification.[5]

Finally, chapter VII will consider the path going forward for Scots law in relation to the penalty doctrine. As chapter II will conclude, two of the major justifications for the penalty doctrine are (i) providing certainty for parties and avoiding litigation, and (ii) protecting parties from excessive penalties.[6] Building upon the rationales for the penalty doctrine, this chapter highlights some problems that need to be addressed, and suggests some potential reforms. Specifically, the ambiguity over what constitutes a legitimate interest undermines the argument for introducing the new test: to improve certainty for contracting parties.[7] One potential way to remedy this could be for the liquidated damages/penalty clause to limit the amount of damages that could be sought if the creditor chose to raise an action.

It is argued that the Consumer Rights Act 2015 did not provide sufficient protection for the claimant in *ParkingEye*.[8] Consequently, it is further argued that additional protections for consumers should be introduced into the penalty doctrine, taking into account the subjective characteristics of the consumer. More general protections should also be introduced through the Scottish court's equitable jurisdiction, and the proportionality of the penalty relative to its effect on the debtor should also be considered under the penalty doctrine. Lastly, chapter VIII will provide an overview of the main conclusions.

B. CHAPTER II: SCOTS LAW ON PENALTY CLAUSES PRIOR TO *CAVENDISH*

This chapter will examine the development of the penalty doctrine in Scots law in order to lay the foundations for evaluating the way in which *Cavendish* fits into the existing Scottish legal landscape. This chapter will focus principally on Scots law, and *Cavendish* will be considered in the next chapter. This chapter will begin by examining the origins of the penalty doctrine, before focusing on its rationale, ambit, and effects in early Scots law. The second section will go on to outline the key cases of the 19th century that established the modern approach prior to *Cavendish*.

(1) Origins of the penalty doctrine

[5] *Cavendish*, at para 252 per Lord Hodge.
[6] *Henderson v Maxwell* (1802) Mor 10054 at 10055.
[7] S Rowan, "The Legitimate Interest in Performance in the Law on Penalties" (2019) 78(1) Cambridge Law Journal 148 at 149; *Cavendish* at para 33 per Lords Neuberger and Sumption.
[8] L A DiMatteo, "Civil-Common Law Divergence on Penalties: Is it a Thing of the Past?" (2022) 43(2) Liverpool Law Review 421 at 446.

At its inception, the penalty doctrine was connected with usury, which is the illegal charging of interest on loans.[9] Usury was disapproved of by Canon Law, one of the sources of Scots law.[10] In Scotland, the prohibition on usury was ended by legislation in 1587, and parties were permitted to charge interest at a rate stipulated by statute.[11] Initially, the rate of interest parties could legally charge was 10%.[12] Hence, usurious contracts were only those where there was "unlawful, or exorbitant profits beyond the law."[13]

The penalty doctrine was justified on the same basis as the laws against usury: preventing creditors from reaping "exorbitant" profits and preventing "undue advantage" being taken of debtors.[14] The earliest recorded cases from the 16th century are cited by Balfour in his Practicks as authority for the proposition that a man obligated to pay money could be required to pay double; likewise, obligations to pay a stipulated sum of money for failure to pay a principal amount or perform a contractual obligation were enforceable.[15]

However, in *Home* v *Hepburn*, the Court of Session held that "regarding the practical aspects of the kingdom, conventional penalties cannot be imposed, except insofar as the plaintiffs are interested, because they are interested in a certain usury and dishonest gain."[16] According to Bell, this case is the earliest Scottish case where "conventional penalties were held to be no farther exigble […] than to the amount of the real damage and interest, because they approach too near to usury."[17] Interestingly, in *Home* itself the court upheld the penalty as it arose from the defenders' failure to hand over an Englishman.[18] Therefore, it appears that the original conception of the penalty doctrine in *Home* was an exception to the general rule that sums stipulated for breach of contract would be enforceable. *Home* has been interpreted in different ways by academics.

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[9] Discussion Paper on *Penalty Clauses* (Scot Law Com No 162, 2016) para 2.10; S Bogle, "Spiritual Duties and Legal Debts in Seventeenth Century Scotland: A Preliminary Study" available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=5164494 7.
[10] Stair, *Inst*, 1.15.7; J Cairns, "Historical Introduction", in R Zimmermann and K Reid (eds), *A History of Private Law in Scotland* vol 1 (2000) at 30.
[11] Act Concerning the Punisement of Usury 1587/7/45; Stair, *Inst*, 1.15.7.
[12] Stair, *Inst*, 1.15.7.
[13] Stair, *Inst*, 1.15.7.
[14] Bell, *Com* III, 655.
[15] Balfour, *Practicks* 150-151.
[16] *Home* v *Hepburn* (1549) Mor 10033: "de practica regni, pænæ conventionales non possunt exigi, nisi quatenus interest actores, quia sapiunt quendam usuram et inhonestum questum."
[17] Bell, *Com* III, 656.
[18] *Home* v *Hepburn* (1549) Mor. 10033.

summarised the case as finding that "conventional penalties would only be exigible to the extent of legal interest."[19] In contrast, Smith interpreted it as meaning that "only damage suffered" could be recovered, not conventional penalties.[20] Prima facie, this distinction may appear to be a narrow one, but it will be important to the analysis of *Cavendish* and the prior Scots law in chapter IV.

However, the adoption of the penalty doctrine was not a linear process. Even after *Home*, there are multiple cases from the 17th and 18th centuries where the courts enforced penalty clauses.[21] In other cases, the Court of Session reduced penalties that were found to be "exorbitant", but appears to have permitted partial recovery on a penal basis, rather than restricting recovery to loss.[22]

(a) Rationale underpinning the penalty doctrine

The rationale behind the penalty doctrine in the old Scottish cases has changed considerably over the centuries since its creation. This subsection sets out the evolution of views regarding the purpose of the penalty doctrine, because it had a practical effect on the ambit and consequences of the penalty doctrine. As mentioned in the previous subsection, the initial justification for the penalty doctrine was that such clauses were akin to usury and hence should not be enforced as they were dishonourable.[23]

The next stage in the development of the penalty doctrine was to recognise that parties should be permitted to stipulate sums to be paid on breach of contract to avoid the expense and difficulty associated with obtaining damages.[24] To make sense of this approach, it is necessary to first outline the meaning of damages, in order to understand how a stipulated sum could be perceived as an appropriate substitute.

Damages are a remedy for breach of contract that has resulted in loss to the innocent party.[25] If a debtor fails to perform their contractual obligations, they must compensate the creditor for the "damage he has sustained through the non-performance, agreeably to the rule, *Loco facti non praestabilis, vel non praeftiti, succedit damnum et interesse*."[26] Translated, the Latin means that "in place of the act that could not be performed or was not performed, the loss and interest succeed." Erskine does not

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[19] J Thomson, "Judicial Control of Unfair Contract Terms", in K Reid and R Zimmermann (eds), *A History of Private Law in Scotland II: Obligations*, vol 2 (2000) 157 at 157.
[20] TB Smith, *A Short Commentary on the Law of Scotland* (1962) 857.
[21] W W McBryde, *The Law of Contract in Scotland,* 3rd edn (2007) para 22-148; *Creditors of Auchinbreck* (1769) Mor 268; *M'Brair* v *Rome* [1683] 2 Brn 49.
[22] Brown's Synopsis, I, II, 6.
[23] *Home*; Bell, *Com* I, 655.
[24] Craig, *Jus Feudale*, II, 3, 37.
[25] McBryde, *Contract* para 22-01.
[26] Erskine, *Inst* II, 481.

define “interest” in this context.[27] Dicta from the early cases on damages make clear that they are a compensatory remedy: liability is described as being for the “damage” or “loss” suffered by the pursuer, although there are also references to “interest”.[28] The modern cases are clear: the breach of contract must cause the pursuer to suffer *damnum* or loss to entitle them to receive damages.[29] As a result, the general rule for the measure of damages is that it is a sum of money that will put the pursuer “in the same position as he would have been in if he had not sustained the wrong for which he is now getting his compensation.”[30]

Under an Act of Sederunt passed in 1592, the Court of Session sanctioned recovery of a ‘liquidate penalty’ on the basis that “damages are often difficult of assessment and that to require proof in all cases would multiply litigation.”[31] Craig stated that prior to the 1592 Act “a liquidate penalty could not be recovered beyond the amount of damage proved” as enforcing a “a liquidate penalty for a venial breach […] savoured of usury.”[32]

Subsequent cases commonly referred to the test for the penalty doctrine as classifying the stipulation as either (i) ‘liquidated damages’, or (ii) a ‘penalty.’[33] This terminology is itself revealing about the nature of the award. In contract law, ‘liquid’ sums are quantified and payable, whereas ‘illiquid’ sums are unquantified and not yet payable. Damages are the pecuniary award for breach of contract. Therefore, the term ‘liquidated damages’ appears to refer to an award of damages that has been quantified by the parties during drafting which is payable on breach. This approach is illustrated by *Henderson v Maxwell*.[34] The Court of Session found that a “conventional penalty” was “substituted” to prevent the “tedious and expensive investigation necessary for providing the real damage,” while a penal sum over and above performance would be restricted to the actual damage incurred, or be liable to the objection of usury.[35]

Subsequently, in *Craig* v *M’Beath*, the Lord Justice-Clerk criticised the approach in *Home* which connected the penalty doctrine to objections against usury.[36] The Lord Justice-Clerk stated that the reason for the penalty doctrine was that “[p]arties cannot lawfully enter into an agreement that the one party shall be punished at the suit of the

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[27] Erskine, *Inst* II, 481.
[28] *Lauchlan Lesly* v *Guthrie* (1670) Mor 3148 at 3149; *Creditors of David Currie* v *William Hannay* (1791) Mor 3162 at 3163.
[29] *Wilkie* v *Brown* 2003 SC 573 at para 21 per Lord Justice-Clerk Gill.
[30] *Livingstone* v *The Rawyards Coal Company* (1880) 5 App Cas 25 at 39 per Lord Blackburn.
[31] Craig, *Jus Feudale*, II, 3, 37; Act of Sederunt 27 Nov 1592.
[32] Craig, *Jus Feudale*, II, 3, 37.
[33] *Commercial Bank of Scotland Ltd* v *Beal* (1890) 18 R 80 at 85 per Lord Justice-Clerk; *Forrest & Barr* v *Henderson, Coulborn & Co* (1869) 8 M 187 at 193 per Lord Kinloch; *Robertson* v *Alexander* (1881) 8 R 555 at 562 per Lord Young.
[34] *Henderson v Maxwell* (1802) Mor 10054.
[35] *Henderson* at 10055.
[36] *Craig* v *M’Beath* (1863) 1 M 1020 at 1022 per Lord Justice-Clerk Inglis.

other."[37] This might be construed as a natural progression from viewing penalty clauses as a substitute for damages, given that it is a compensatory remedy. Although these three analyses offer different rationales for the penalty doctrine, all three are compensatory in nature.

There is also limited authority that penalty clauses could be enforceable as deterrents. Lord Kames described penalty clauses as a "spur on the debtor to perform."[38] In *Lawson* v *Ogilvy*, the Lord President considered the purpose of the additional rent, which was to ensure that a prescribed system of agricultural work was carried out.[39] The Lord President referred to agricultural advancements that had been accomplished by the landlords preventing deviations. The Lord President made no reference to the loss actually suffered by the landlord. Thus, in *Lawson* the Court of Session appears to have upheld a penalty clause as a justified deterrent.

(b) Ambit of the penalty doctrine

This subsection describes the way in which the penalty doctrine operated under the old Scots law. Bell distinguished between the approaches for clauses secondary to obligations *ad factum praestandum* and pecuniary obligations.[40] For obligations *ad factum praestandum*, Bell stated that where penalties are intended as liquidated damages, and where there appears to be "nothing exorbitant" in the stipulation, but a "reasonable and fair proportion between the loss and the penalty", a court will not interfere."[41] Regarding the breach of obligations to pay sums of money, Bell stated that legal interest was the "proper damage", and the cost of making the debt effectual was recoverable.[42]

Over the course of the 19th century, the test for the penalty doctrine had broadly begun to settle into shape, and a number of rules and principles had developed.[43] The courts do not appear to make reference to Bell's distinction. Instead, the basic procedure of the courts was to determine whether the clause was a penalty, or whether it was liquidate damages.[44] The courts held that if the sum stipulated for "bore a clear proportion to the

[37] *Craig* at 1022 per Lord Justice-Clerk Inglis.
[38] Lord Kames, *Principles of Equity,* III, II, 153.
[39] *Lawson* v *Olgivy* (1832) 10 S 531 at 533 per Lord President.
[40] Bell, *Comm* I, 655.
[41] Bell, *Comm* I, 655.
[42] Bell, *Comm* I, 657.
[43] McBryde, *Contract* para 22-148.
[44] *Commercial Bank of Scotland Ltd* v *Beal* (1890) 18 R 80 at 85 per Lord Justice-Clerk; *Forrest & Barr* v *Henderson, Coulborn & Co* (1869) 8 M 187 at 193 per Lord Kinloch; *Robertson* v *Alexander* (1881) 8 R 555 at 562 per Lord Young.

amount of loss sustained" it was likely to be a liquidated damages clause.[45] Other ways in which the proportionality requirement was expressed included whether the sum was "exorbitant" or "unconscionable."[46] The proportionality assessment was determined at the time the provision was made.[47] If a sum was stipulated as applicable on any breach of contract, large or small, it was indicative that the clause was likely a penalty as it was likely to be disproportionate to the loss suffered.[48]

The latitude provided by the proportionality requirement is illustrated by *M'Kirdy* v *Paterson*.[49] Lord Justice-Clerk Hope quoted Lord Eldon's conclusion that the parties may ascertain the damage themselves and "unless they are so aukward as to put that in the shape of penalty, instead of liquidated damages" they would have a good remedy.[50] Lord Eldon's dictum originates from an English case, which correlates with the suggestion that the penalty doctrine was "essentially the same" in English law and Scots law.[51]

Arguably the most significant element of the penalty doctrine was the approach taken to burden of proof. Originally, a pursuer was entitled to bring an action for the full amount of the penalty, without alleging that they had suffered loss, or alleging a particular amount.[52] The onus lay on the defender to prove that the pursuer's loss was less than the amount stipulated in the penalty.[53] This was entirely consistent with the approach which viewed purported penalty clauses as having a legitimate purpose as a substitute for damages and thereby avoiding time-consuming, expensive litigation, particularly in cases where loss could be difficult to prove. Lastly, the terms used by the parties are not definitive in determining whether the clause is a penalty.[54] Instead the court will consider the substance of the stipulation.[55] Importantly, this rule enables the penalty doctrine to function by preventing parties from avoiding it via clever drafting.

(c) Consequences of the penalty doctrine

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[45] *Craig* at 1022 per Lord Justice-Clerk Inglis; *Johnston* v *Robertson* (1861) 23 D 646 at 655 per Lord Justice-Clerk Inglis.
[46] *Lord Elphinstone* v *Monkland Iron and Coal Co Ltd* (1886) 13 R (HL) 98 at 109 per Lord Fitzgerald; *Forrest* at 193 per Lord Kinloch.
[47] *Forrest* at 193 Lord Kinloch.
[48] *Craig* at 1022 per Lord Justice-Clerk Inglis.
[49] *M'Kirdy* v *Paterson* (1854) 16 D 1013.
[50] *M'Kirdy* at 1020 per Lord Justice-Clerk Hope; *Baker* v *Shackle* 33 ER 600, (1808) 14 Vesey Junior 468 at 600 per Lord Eldon.
[51] *Cavendish Square Holding BV* v *Makdessi*; *ParkingEye Ltd* v *Beavis (Consumers' Association Intervening)* [2015] UKSC 67, [2016] AC 1172 at para 216 per Lord Hodge.
[52] *Craig* v *M'Beath* (1863) 1 M. 1020 at 1022 per Lord Justice-Clerk Inglis.
[53] Thomson, (n 19) at 158.
[54] *Johnston* at 654 per Lord Cowan.
[55] *Johnston* at 654 per Lord Cowan.

There were two primary outcomes once a clause was found to be a penalty: (i) the court may refuse to enforce the clause, or (ii) the court may exercise its equitable power to modify the sum stipulated.[56] If the court refused to enforce the clause, the normal remedy of damages would be available to the parties.[57] Initially, damages were capped at the sum stipulated for in the penalty, as it was felt that it would be unfair for pursuers to obtain an advantage under the penalty doctrine.[58] However, it was later held that damages would not be limited to the sum stipulated.[59] Lord Salvesen found that, because damages are awarded in substitution of contractual performance, limiting compensation would mean that the party in breach could "escape all the consequences of his breach", which would be contrary to principle.[60]

Where the penalty was found to be "exorbitant" the court had a power in its equitable jurisdiction to modify the penalty.[61] The power of modification could be exercised to reduce the sum stipulated to the "actual loss" suffered.[62] In *Mackenzie* v *Gilchrist*, Lord President Hope contended that the Court's modification power caused problems for pursuers by providing that proof of damage was again necessary, which was often "impossible, at least tedious and difficult."[63] This could suggest that liquidated damages clauses are impractical. Yet, the pursuer was "entitled to bring his action for the full amount of the penalty, without alleging that he has suffered damage, or alleging the amount of damage", and the onus lay on the defender to allege that the damage was not so great.[64] Otherwise, making a stipulation would have no value.[65]

(2) Development in the 20th century

This section focuses on the three key cases from the turn of the 20th century which crystalised the Scottish approach to the penalty doctrine prior to *Cavendish*.[66] *Clydebank Engineering and Shipbuilding Co Ltd* v *Don Jose Ramos Yzquierdo Y Castaneda* introduced the 'genuine pre-estimate of loss' test.[67] Thomson highlighted the

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[56] *Wright* v *M'Gregor* (1826) 4 S 434 at 436 per Lord Alloway.
[57] Discussion Paper on *Penalty Clauses* (Scot Law Com DP No 103, 1997) para 2.10.
[58] *Lord Elphinstone* v *Monkland Iron and Coal Co Ltd* (1886) 13 R (HL) 98 at 108 per Lord Fitzgerald.
[59] *Dingwall* v *Burnett* 1912 SC 1097 at 1106-1107 per Lord Salvesen.
[60] *Dingwall* at 1106 per Lord Salvesen.
[61] *Wright* at 437 per Lord Glenlee.
[62] *Wright* at 436 per Lord Alloway.
[63] *Mackenzie* v *Gilchrist* 1811 FC 419 at 427 per Lord President Hope.
[64] *Craig* v *M'Beath* (1863) 1 M 1020 at 1023 per Lord Justice-Clerk Inglis.
[65] *Craig* at 1023 per Lord Justice-Clerk Inglis.
[66] *Clydebank Engineering and Shipbuilding Co Ltd* v *Don Jose Ramos Yzquierdo Y Castaneda* [1905] AC 6; *Commissioner of Public Works* v *Hills* [1906] AC 368; *Dunlop Pneumatic Tyre Company* v *New Garage and Motor Company* [1915] AC 79.
[67] *Castaneda and Others* v *Clydebank Engineering and Shipbuilding Co Ltd* (1903) 10 SLT 622 at 625 per Lord Kyllachy; *Clydebank* at 19 per Lord Robertson.

significance of this development: pursuers would be unable to enforce a penalty clause unless they could establish that it was a genuine pre-estimate of loss.[68] Hence, *Clydebank* resulted in a reversal of the presumption that a penalty clause was valid.[69] This change dramatically decreased the utility of penalty clauses, and arguably undermined their purpose by increasing the likelihood of litigation.

In *Commissioner of Public Works* v *Hills*, Lord Dunedin (applying *Clydebank*), concluded that the indica to determine whether a clause was a genuine pre-estimate of loss were a matter of fact and circumstances, which must be looked at as a whole.[70] Yet, he found that "enormous disparity" of the sum stipulated to "any conceivable loss will point one way," and a stipulation "proportionate to the loss" would point the other way.[71] This configuration of the proportionality assessment is broadly consistent with the earlier law. In *Hills*, the "determining factor" was that the sum stipulated for was not definite, but was "liable to great fluctuation […] dependent on events not connected with the fulfilment of [the] contract."[72]

Finally, *Dunlop Pneumatic Tyre Company* v *New Garage and Motor Company* was the leading case in Scotland on the penalty doctrine prior to *Cavendish*. Unlike *Clydebank* and *Hills*, there were no significant changes in the law under *Dunlop* – instead, current principles and rules were collated in Lord Dunedin's dicta. It was established that the court would look to the substance of the clause, not the label as a 'penalty' or liquidated damages, and whether the clause was a genuine pre-estimate of loss.[73]

Lord Dunedin also set out four tests to help determine whether a clause was a penalty.[74] Firstly, whether the sum stipulated is "extravagant and unconscionable […] in comparison with the greatest loss that could conceivably be proved to have followed from the breach."[75] Secondly, if the only breach of contract is the failure to pay a principal sum of money, and the provision stipulates that a secondary sum greater than the principal amount is due, then it will be held to be a penalty.[76] Thirdly, stipulations for payment of a single lump sum for one or more events, of a mixture of trifling and serious damage, are presumed to be penalties.[77] Fourthly, difficulty in making a precise pre-

[68] Thomson (n 19) at 159.
[69] Thomson (n 19) at 159.
[70] *Hills* at 375-376 per Lord Dunedin).
[71] *Hills* at 376 per Lord Dunedin).
[72] *Hills* at 376 per Lord Dunedin.
[73] *Cavendish Square Holding BV* v *Makdessi*; *ParkingEye Ltd* v *Beavis (Consumers' Association Intervening)* [2015] UKSC 67, [2016] AC 1172 at para 15 per Lords Neuberger and Sumption; *Dunlop* at 86 per Lord Dunedin.
[74] *Dunlop* at 87 per Lord Dunedin.
[75] *Dunlop* at 87 per Lord Dunedin.
[76] *Dunlop* at 87 per Lord Dunedin.
[77] *Dunlop* at 87 per Lord Dunedin.

estimation was not an obstacle to the sum stipulated for being a genuine pre-estimate of damage.[78]

(3) Conclusion

Overall, by the end of the 20th century, the courts had developed a sophisticated approach to the penalty doctrine as a mechanism for protecting parties from exorbitant sanctions for breach of contract. Parties were permitted to stipulate liquidate damages, an estimate of the loss they were likely to suffer on breach, to provide them with a more efficient remedy than damages. Liquidate damages were necessarily of a compensatory character, as parties were not permitted to contract to punish one another. As a result, exorbitant stipulations would either be modified or unenforceable and the parties would have to sue for damages. Nevertheless, given that parties were necessarily unaware of their precise losses at the time of drafting the stipulation, parties were provided some latitude via the proportionality test.

C. CHAPTER III: *CAVENDISH* AND THE ENGLISH APPROACH TO THE PENALTY DOCTRINE

Having examined the traditional Scottish approach to the penalty doctrine, this section will begin by examining the new test laid down by the Supreme Court in *Cavendish*. This chapter considers the legitimate interest and proportionality requirements, with reference to English cases preceding and following *Cavendish*. The aim is to highlight the relevant factors under the *Cavendish* approach to the penalty doctrine to develop a foundation for comparison with the orthodox Scottish approach in chapter IV.

(1) *Cavendish*

The modern approach to the penalty doctrine was set out by the Supreme Court in the conjoined appeals of *Cavendish Square Holding BV* v *Makdessi* and *ParkingEye Ltd* v *Beavis (Consumers' Association Intervening)*.[79] *Cavendish* concerned a restrictive covenant following the sale of shares in a company.[80] *ParkingEye* involved the imposition of a parking charge of £85 on drivers who overstayed the two-hour free limit for free parking.[81] Critical to *Cavendish* was the need to classify a provision as a

[78] *Dunlop* at 87-88 per Lord Dunedin.
[79] *Cavendish Square Holding BV* v *Makdessi*; *ParkingEye Ltd* v *Beavis (Consumers' Association Intervening)* [2015] UKSC 67, [2016] AC 1172.
[80] *Cavendish* at para 46 per Lords Neuberger and Sumption.
[81] *Cavendish* at paras 89-93 per Lords Neuberger and Sumption.

secondary obligation (triggered by the breach of a primary contractual obligation), or a conditional primary obligation.[82] The classification of provisions as secondary or conditional primary obligations will not be discussed further due to the scope of this dissertation.

Fundamental to the judgments from Lords Neuberger and Sumption is freedom of contract, and the view that the courts should not interfere where one of the parties has simply struck a bad bargain.[83] All three of the main judgments found that whether the parties had legal advice was relevant in determining whether a provision was a penalty, although differences arose on the importance placed on this factor.[84] For instance, Lords Neuberger and Sumption held that there was a "strong initial presumption" where parties had benefitted from legal advice and were of "comparable bargaining power" that liquidated damages clauses would be legitimate.[85] Although Lords Mance and Hodge clearly identified interference with freedom of contract as an important consideration, they did not go as far as concurring that there would be such a presumption.[86]

All three of the main judgments in *Cavendish* set out a two-part test for whether a clause was an unenforceable penalty: (1) whether it protected a legitimate interest, and (2) whether the proposed sanction was proportionate to the interest being protected.[87] Significantly, the Supreme Court held that interests "beyond the compensatory" could justify additional sanctions on breach and that deterrent provisions were not necessarily penal.[88]

Yet, the Supreme Court also considered that in the case of a "straightforward damages clause, [the] interest will rarely extend beyond compensation" in which case Lord Dunedin's approach would "usually be perfectly adequate to determine its validity."[89] This indicates that Lord Dunedin's traditional approach will continue to remain relevant to the penalty doctrine in simple cases.

Additionally, *Cavendish* provided parties with significant leeway for satisfying the proportionality requirement.[90] Different language was used by the judges to describe

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[82] *Cavendish* at paras 13-14 per Lords Neuberger and Sumption.
[83] *Cavendish* at para 33 per Lords Neuberger and Sumption.
[84] *Cavendish* at para 35 per Lord Neuberger and Sumption; para 152 per Lord Mance); para 274 per Lord Hodge.
[85] *Cavendish* at paras 35 and 43 per Lords Neuberger and Sumption.
[86] *Cavendish* at para 152 per Lord Mance; para 274 per Lord Hodge.
[87] *Cavendish* at para 32 per Lords Neuberger and Sumption; para 152 per Lord Mance; para 255 per Lord Hodge.
[88] *Cavendish* at paras 28 and 31 per Lords Neuberger and Sumption; paras 152 and 198 per Lord Mance; para 248 per Lord Hodge.
[89] *Cavendish* at para 32 per Lords Neuberger and Sumption.
[90] *Cavendish* at para 32 per Lords Neuberger and Sumption; para 152 per Lord Mance; para 255 per Lord Hodge.

this requirement – for example, Lord Hodge stated that the remedy stipulated for breach of contract would need to be "exorbitant or unconscionable" to be deemed a penalty.[91] Lords Neuberger and Sumption described the requirement as whether the provision was "out of all proportion."[92] Lord Mance used the terms "unconscionable or manifestly excessive."[93] All of these terms appear to permit a "broad margin of error" before a provision will be considered a penalty. [94] The court stated that extravagance and unconscionability have the same meaning in this context.[95] It has been claimed that in the context of the penalty doctrine, 'extravagance', 'exorbitance', and 'unconscionability' are simply "old-fashioned ways" to refer to proportionality, and this dissertation takes the same view.[96]

With respect to the proportionality analysis, the court also quoted approvingly Lord Wright's opinion that the proportionality assessment would be applied in the same way regardless of whether the stipulation affected a millionaire or a poor man.[97] Finally, the proportionality assessment is to be carried out according to the time that the contract was formed.[98]

Having described the legitimate interest test introduced in *Cavendish*, a number of questions arise, such as, what constitutes a legitimate interest for the purposes of the test, and when will a clause be considered disproportionate?[99] Arguably there is a sense in which a party may always have an interest in deterring breach which goes beyond compensation.[100] In *Cavendish*, the court referred to the concept of legitimate interest in other areas of contract law: namely specific performance and an innocent contracting party's ability to insist on providing performance after repudiation.[101] A number of factors have been highlighted as potentially relevant to whether an interest is legitimate based on the requirements of these doctrines.[102] Chapter V will question whether the legitimate interest described in these doctrines shares a common meaning with the penalty doctrine after *Cavendish*. Therefore, the rest of this chapter will focus

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[91] *Cavendish* at para 255 per Lord Hodge.
[92] *Cavendish* at para 32 per Lords Neuberger and Sumption.
[93] *Cavendish* at para 179 per Lord Mance.
[94] R Halson, "The Critical Reception of Cavendish Square Holdings v Makdessi", in E Peel and R Probert (eds), *Shaping the Law of Obligations: Essays in Honour of Professor Ewan McKendrick KC* (2023) 193 at 204.
[95] *Cavendish* at para 31 per Lords Neuberger and Sumption; para 152 per Lord Mance; para 293 per Lord Toulson.
[96] W Day, "Disproportionate Penalties in Commercial Contracts", in P S Davies and M Raczynska (eds), *Contents of Commercial Contracts: Terms Affecting Freedoms* (2020) 211 at 224.
[97] *Cavendish* at para 32 per Lords Neuberger and Sumption; *Imperial Tobacco Company (of Great Britain) and Ireland* v *Parslay* [1936] 2 All ER 515 at 523 per Lord Wright.
[98] *Cavendish* at para 294 per Lord Hodge.
[99] Rowan (n 7) at 149.
[100] C Conte, "The Penalty Rule Revisited" (2016) 132(Jul) Law Quarterly Review 382 at 387.
[101] *Cavendish* at para 30 per Lords Neuberger and Sumption.
[102] *Chitty on Contracts*, 35th edn, vol I, paras 30-230-30-232, 30-234-30-236, and 30-237.

specifically on what the English cases before and after *Cavendish* indicate about (i) the legitimate interest, and (ii) proportionality requirements of the penalty doctrine.

(2) The 'commercial justification' cases

This subsection begins by examining the 'commercial justification' cases, which were cited by all three of the major judgements in *Cavendish* and therefore provide guidance on the legitimate interest requirement.[103] Despite the changes wrought by *Cavendish*, the English courts have continued to refer to the commercial justification cases when determining whether an interest is legitimate.[104]

Prior to the commercial justification cases, Lords Diplock and Woolf argued that the courts should take a cautious approach to finding a stipulation to be a penalty, with reliance upon three primary reasons.[105] Those three reasons are: improving certainty of outcomes for contracting parties, avoiding the costs of litigation, and respecting the parties' freedom of contract.[106] Both judgments were cited approvingly by the majority of the Supreme Court in *Cavendish*.[107] The three reasons are relevant to the discussion of the commercial justification cases as they acted as a touchstone for the approach taken in this line of cases.[108] The first case in the line of commercial justification cases is generally considered to be Colman J's "celebrated" decision in *Lordsvale Finance Plc* v *Bank of Zambia*.[109] *Lordsvale* was certainly a landmark case, but it should be viewed within a general trend of "judicial reticence" to the penalty doctrine which predated it by decades; *Philips Hong Kong Ltd* v *Attorney General of Hong Kong* has been described as the "first indication" that change was on the horizon.[110]

In *Lordsvale*, Colman J reframed the "in terrorem" aspect of *Dunlop* as a question of whether the "predominant contractual function of the provision was to deter a party from

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[103] *Cavendish* at para 29 per Lords Neuberger and Sumption; para 146 per Lord Mance; para 222 per Lord Hodge.
[104] *Cargill International Trading Pte Ltd* v *Uttam Galva Steels Ltd* [2019] EWHC 476 (Comm), at [43]-[44] (Bryan J).
[105] *Robophone Facilities Ltd* v *Blank* [1966] 1 WLR 1428 at 1447 per Lord Diplock; *Philips Hong Kong Ltd* v *Attorney General of Hong Kong* [1993] 61 BLR 41, Const LJ 1993, 9(3) at 202-213, 207 per Lord Woolf.
[106] *Robophone* at 1447 per Lord Diplock; *Philips* at 202-213, 207 per Lord Woolf.
[107] *Cavendish* at para 33 per Lords Neuberger and Sumption.
[108] *Murray* v *Leisureplay Plc* [2005] EWCA Civ 963, at para 66 per Arden LJ; para 106 per Clarke LJ; para 114 per Buxton LJ.
[109] *Lordsvale Finance Plc* v *Bank of Zambia* [1996] 3 WLR 688, [1996] QB 752; *Cavendish* at para 222 per Lord Hodge; B Macfarlane, "Penalties and Forfeiture" in J McGhee (ed), *Snell's Equity* 33rd edn (2015) at para 13-012.
[110] K K C Leung, "The Penalty Rule: A Modern Interpretation" (2017) 29 Denning Law Journal 41 at 53; P D Baron, "The Doctrine of Penalties and the Test of Commercial Justification" (2008) University of Western Australia Law Review 34(1) 42 at 52.

breaking the contract."[111] He further found that where there is a discrepancy between the stipulated sum and the potential amount of loss resulting from breach, the function is likely to be deterrence, rather than compensation.[112] Colman J also emphasised that the purpose of the penalty doctrine is to protect parties from the effect of penalty clauses, rather than enforcing liquidated damages clauses.[113] On this basis, although he acknowledged the dichotomous approach in *Dunlop*, Colman J concluded that there was no reason to decide that a clause was a penalty if it could "in the circumstances be explained as commercially justifiable, provided always that its dominant purpose was not to deter […] breach." [114]

The development of the commercial justification cases was not straightforward, and subsequent cases did not uncritically adopt Colman J's rationale. In *Murray* v *Leisureplay Plc*, Buxton LJ favoured the traditional *Dunlop* approach and held that there was "no middle ground": stipulations were either genuine pre-estimates of loss or deterrent penalties.[115] Buxton LJ highlighted the willingness of the House of Lords in *Dunlop* to look at the "commercial context" of the stipulation.[116]

The facts in *Lordsvale* were of central importance to Colman J's reasoning, and illustrate the tension between the requirements of commerce, and the strict *Dunlop* approach.[117] *Lordsvale* concerned the enforcement of clauses in loans requiring the debtor to pay an increased interest rate of 1% upon default of a syndicated loan facility.[118] In New York, such clauses had already been found to be enforceable.[119] This international and commercial context was highly influential in *Lordsvale*.[120] Repeatedly, Colman J referred to concerns for London's banking sector should he have found the clause to be a penalty, as default interest rate uplift was commonly used in loan agreements.[121]

In *Makdessi* v *Cavendish Square Holdings BV*, Christopher Clarke LJ referred to *Jeancharm Ltd* v *Barnet Football Club Ltd* while discussing the authorities.[122] *Jeancharm* had very similar facts to *Lordsvale* but the Court of Appeal applied the

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[111] *Lordsvale* at 762 per Colman J.
[112] *Lordsvale* at 762 per Colman J.
[113] *Lordsvale* at 763 per Colman J.
[114] *Lordsvale* at 763-764 per Colman J.
[115] *Murray* at para 111 per Buxton LJ.
[116] *Murray* at para 118 per Buxton LJ.
[117] Raphael Lok Hin Leung, "In Defence of the Halfway House – The Cavendish Penalty Rule since 2015" (2019) 13 Hong Kong Journal of Legal Studies 55 at 59.
[118] *Lordsvale* at 761 per Colman J.
[119] *Citibank NA* v *Nyland (CF8) Ltd* (1989) 878 F 2d 620 at 625 per Jon O Newman; *Lordsvale* at 765-766 per Colman J.
[120] Leung (n 110) at 53.
[121] *Lordsvale* at 761- 762 and 767-768 per Colman J.
[122] *Makdessi* at paras 70 and 86-88 per Christopher Clarke LJ; *Jeancharm Ltd* v *Barnet Football Club Ltd* [2003] EWCA Civ 58.

genuine pre-estimate of loss test.[123] Jacob J considered *Lordsvale* in his judgment, but mischaracterised the uplift as a "genuine pre-estimate" on the basis that the default indicated that the borrower's ability to repay was at risk.[124] Christopher Clarke LJ claimed that the clause in *Lordsvale* was "sufficiently close to a pre-estimate" and represented "modest additional compensation" because the risk to the bank was greater than initially anticipated.[125] While it is clear that Colman J did not follow the *Dunlop* approach, it is uncertain whether it was necessary to depart from *Dunlop*: the increased interest rate could have been construed as reflecting an increase in the price of money associated with an increase in the risk to the bank following the debtor's default.[126]

In addition to the commercial concerns outlined, Colman J also considered the public interest in deciding whether the relevant clause was a penalty.[127] This was further developed by Moore-Bick LJ in *ParkingEye Ltd* v *Beavis*.[128] Moore-Bick LJ found that it was "difficult to see why justification for payment of a sum unrelated to financial loss should depend solely on commercial as opposed to some other kinds of considerations."[129] The Court of Appeal had regard to the fact that, based on applicable legislation, "Parliament considered it to be in the public interest that parking charges […] should be recoverable."[130] Hence, although *Lordsvale* and the other commercial justification cases primarily focused on commercial reasons for enforcing a clause that was not a genuine pre-estimate of loss, there was also consideration of the broader public interest.[131]

Moreover, *ParkingEye* was significant within the context of the commercial justification cases as it was the first case which held that a clause aiming to deter breach may still be enforceable.[132] In this respect, Sir Timothy Lloyd's judgment marked a radical departure from the *Lordsvale* approach. In *Lordsvale*, Colman J's decision turned on a distinction between penalty clauses which aimed to deter breach, and clauses that could be justified with reference to the commercial context.[133] Sir Timothy Lloyd accepted that in commercial cases, an intention to deter and terms imposing excessive

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[123] *Jeancharm* at para 15 per Jacob J; para 22 per Keene LJ; para 29 per Peter Gibson LJ.
[124] *Jeancharm* at para 16 per Jacob J.
[125] *Makdessi* at para 88 per Christopher Clarke LJ.
[126] E K Mik, "Subject to Review? Consideration, Liquidated Damages and the Penalty Jurisdiction" in *Obligations VII Conference "Challenging Orthodoxy"* (2014) available at http://dx.doi.org/10.2139/ssrn.251258210; Leung (n 110) at 53.
[127] A Summers, "Unresolved Issues in the Law on Penalties" (2017) (1) Lloyd's Maritime and Commercial Law Quarterly 95 at 112.
[128] *ParkingEye Ltd* v *Beavis* [2015] EWCA Civ 402 at para 28 per Moore-Bick LJ.
[129] *ParkingEye* at para 22 per Moore-Bick LJ.
[130] *ParkingEye* at para 28 per Moore-Bick LJ.
[131] Summers (n 127) at 112.
[132] *ParkingEye* at para 47 per Sir Timothy Lloyd; *Chitty on Contracts,* 35th edn para 30-226.
[133] *Lordsvale* at 762 per Colman J.

obligations may show that a clause is "extravagant and unconscionable."[134] Nevertheless, he concluded that in non-commercial cases a deterrent purpose is "not sufficient in itself to invalidate the term."[135]

Overall, the overwhelming trend of the commercial justification cases was to decrease the ambit of the penalty doctrine by increasing the permitted purposes of liquidated damages clauses. Concerns relating to freedom of contract, certainty of outcome for contracting parties, and commercial needs led to a growing number of interests being taken into account, culminating in the legitimate interest test in *Cavendish*. Finally, this review of the commercial justification cases demonstrates the problem with determining whether an interest satisfies the legitimate interest test. Increasing the range of enforceable interests has resulted in the legitimate interest test losing meaning.

(3) Development of the legitimate interest requirement after *Cavendish*

There has been significant criticism of the lack of guidance provided in *Cavendish* on the application of the legitimate interest test.[136] This subsection considers whether the subsequent decisions of the English courts interpreting *Cavendish* clarify which interests will be considered legitimate.

One question raised by *Cavendish* was the extent to which Lord Dunedin's dicta in *Dunlop* would continue to play a role in the operation of the penalty doctrine. In *Cavendish*, Lords Neuberger and Sumption described Lord Dunedin's four tests as a "useful tool" for "simple cases."[137] Furthermore, as Worthington pointed out, in *Cavendish* the Supreme Court formally upheld the authority of *Dunlop*, although the Justices dramatically reinterpreted it.[138] Multiple cases post-*Cavendish* have continued to apply the traditional *Dunlop* approach.[139] In *De Havilland Aircraft of Canada Ltd* v *Spicejet Ltd*, the test applied was whether there was an "exorbitant or extravagant pre-estimate" of loss.[140] There are two main ways in which these judgments can be

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[134] *ParkingEye* at para 51 per Sir Timothy Lloyd.
[135] *ParkingEye* at para 51 per Sir Timothy Lloyd.
[136] *Moises Gertner & Laser Trust* v *CFL Finance Ltd* [2020] EWHC 1241 (Ch), [2020] CTLC 241 at para 137 per Smith J.
[137] *Cavendish* at para 22 per Lords Neuberger and Sumption.
[138] S Worthington, "The Death of Penalties in Two Legal Cultures?" (2016) 7 The United Kingdom Supreme Court Yearbook 129 at 139.
[139] *De Havilland Aircraft of Canada Ltd* v *Spicejet Ltd* [2021] EWHC 362 (Comm) at paras 33-34 per Sir Michael Burton GBE; *Vivienne Westwood Ltd* v *Conduit Street Development Ltd* [2017] EWHC 350 (Ch), [2017] L & TR 23, at paras 63 and 65 per Timothy Fancourt QC; *The Luxury Italian KBB Co Ltd, JNM Home Improvement and Construction Ltd* v *Remon Boutros, Hakima Boutros* [2021] (unreported) at para 85 per Damien Lochrane.
[140] *Spicejet Ltd* at para 34 per Sir Michael Burton GBE.

interpreted: (i) either the judges applied the wrong test, or (ii) the judges essentially added a step to the penalty doctrine analysis.

The analysis bears some resemblance to the approach taken by Christopher Clarke LJ in *Makdessi*. Christopher Clarke LJ first considered whether the clauses could be said to be genuine pre-estimates of loss, not because they were "determinative" but because "[i]f the clauses [were] genuine pre-estimates they [could] scarcely be penal."[141] It was only once he had found that the clauses were not genuine pre-estimates of loss that Christopher Clarke LJ moved on to consider whether there was a commercial justification.[142] Applying the genuine pre-estimate of loss test in this way essentially uses it as a filter to address simpler cases and avoids the need to determine whether an interest is legitimate, albeit not compensatory. Although this step was not envisaged in *Cavendish*, it does appear to align with the suggestion that the traditional approach would continue to be applicable to simpler cases. Adopting this approach would also potentially meet Halson's criticism that a division between simpler and complex cases would "inevitably raise boundary disputes."[143]

In both *Spicejet Ltd* and *Remon Boutros* the judges found that the clauses were genuine pre-estimates of loss and thus were not penalties.[144] Therefore, it may be that they did not consider it necessary to address the more complicated question of whether there were additional legitimate interests beyond compensation. This is supported by the fact that both *Spicejet Ltd* and *Remon Boutros* cited *Cavendish* and referred to the legitimate interest test.[145] In *Remon Boutros*, Judge Damien Lochrane also described the clause as a "justifiable clause to deter non-performance", which is clearly aligned with the approach in *Cavendish*.[146]

However, Judge Damien Lochrane also quoted from *Chitty on Contracts*, which stated that the "correct question" was "whether or not the clause [was] a genuine pre-estimate of the likely loss."[147] Furthermore, in *Spicejet Ltd*, Sir Michael Burton stated that in *Cavendish*, Lord Hodge adopted Lord Dunedin's dicta.[148] Yet, Lord Hodge specified that Lord Dunedin's second point, which sets out the dichotomy between genuine pre-estimates of damage and stipulations in terrorem, has "caused difficulty when it has

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[141] *Makdessi* v *Cavendish Square Holdings BV* [2013] EWCA Civ 1539 at para 105 per Christopher Clarke LJ.
[142] *Makdessi* at para 117 per Christopher Clarke LJ.
[143] R Halson, *Liquidated Damages and Penalty Clauses* (2018) para 2.76.
[144] *Spicejet Ltd* at para 34 per Sir Michael Burton GBE; *Remon Boutros* at para 85 per Damien Lochrane.
[145] *Spicejet Ltd* at paras 27-29 per Sir Michael Burton GBE; *Remon Boutros* at paras 78-79 per Damien Lochrane.
[146] *Remon Boutros* at para 85 per Damien Lochrane.
[147] *Remon Boutros* at para 80 per Damien Lochrane.
[148] *Spicejet Ltd* at para 29 per Sir Michael Burton GBE.

been treated as creating in all cases a dichotomy."[149] As a result, this casts doubt on whether the correct test was applied in *Remon Boutros* and *Spicejet Ltd*.

In contrast, *Vivienne Westwood Ltd* v *Conduit Street Development Ltd* exemplifies a blend of the traditional and modern approaches.[150] A side letter conferred on the tenant a lower rent than reserved by the lease for the first five years.[151] This benefit was conditional, and the lessor had the right to terminate the agreement if the tenant breached any of the terms, reverting the rent to the higher figure under the lease.[152] The lessor argued that they had a legitimate interest in prompt performance since a tenant in default would reduce the value of the lessor's investment.[153] Nevertheless, Sir Timothy Fancourt held that, since he had concluded that the reduction in rent was a substantial term of the contract (not a conditional right), the defendant could not have a legitimate interest in seeing the rent revert to its previous value – the defendant could not have a legitimate interest in the tenant's non-performance.[154]

Subsequently, Sir Timothy Fancourt concluded that the "main difficulty" faced by the defendant was that the "same financial adjustment applie[d] whether a breach [was] one-off, minor, series or repeated, and without regard to the nature of the obligation broken or any actual or likely consequences for the lessor."[155] While inconclusive, this classic indicator of penalties features in Lord Dunedin's dicta.[156] As a result, *Vivienne* demonstrates the enduring significance of *Dunlop*, and the way in which the courts can continue to apply the four tests in a way that is congruent with *Cavendish*.

While the application of the legitimate interest test appears to be developing in an incremental manner, there are nevertheless some factors which have been identified that could be generalised. Rowan set out five main considerations that the courts would likely refer to when determining whether the legitimate interest test was satisfied, two of which refer to other doctrines within contract law, and thus will be discussed in chapter V.[157]

The first factor identified by Rowan is the importance of the term breached, and, linked to that, the severity of consequences of breach.[158] According to Rowan, where an

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[149] *Cavendish Square Holding BV* v *Makdessi*; *ParkingEye Ltd* v *Beavis (Consumers' Association Intervening)* [2015] UKSC 67, at para 221 per Lord Hodge.
[150] *Vivienne Westwood Ltd* v *Conduit Street Development Ltd* [2017] EWHC 350 (Ch), [2017] L & TR 23.
[151] *Vivienne* at para 33 per Timothy Fancourt QC.
[152] *Vivienne* at para 34 per Timothy Fancourt QC.
[153] *Vivienne* at para 50 per Timothy Fancourt QC.
[154] *Vivienne* at para 52 per Timothy Fancourt QC.
[155] *Vivienne* at para 52 per Timothy Fancourt QC.
[156] *Vivienne* at para 53 per Timothy Fancourt QC; *Dunlop Pneumatic Tyre Co Ltd* v *New Garage & Motor Co Ltd* [1915] AC 79 at 87 per Lord Dunedin.
[157] Rowan (n 7) at 164.
[158] Rowan (n 7) at 164.

obligation goes “to the root of the contract or is essential to its working and objectives and breach would deprive the injured party of substantially the whole benefit” of the contract, this factor should weigh positively in finding a legitimate interest.[159] For instance, in *Cavendish*, the Supreme Court emphasised the fact that the loyalty of the sellers was “critically important” to maintaining the value of the goodwill, and that a “large proportion” of the purchase price was attributable to the goodwill.[160] As a result, the buyers were found to have a legitimate interest in protecting the value of the company’s goodwill.[161] The purpose of the alleged penalty clauses was to provide the sellers with a financial incentive to remain loyal to the company.[162] In this way, the clauses in *Cavendish* aligned with the purpose of the contract.

Intertwined with the importance of the term is the question of how the injured party will be affected by the breach of contract.[163] For example, in *Vivienne Westwood* the fact that trivial breaches were unlikely to have a significant effect on the lessor’s interests was relevant to the assessment of whether the lessor had a legitimate interest.[164] When evaluating the potential consequences of breach, the effect of the breach on a wider scheme has also been taken into account. In *Eco World – Ballymore Embassy Gardens Co Ltd* v *Dobler UK Ltd*, O’Farrell J highlighted the way in which the effect of late completion of any part of the construction would likely adversely impact the rest of the work, “causing not just delay but also disruption to the project as a whole.”[165] As a result, O’Farrell J concluded that there was a legitimate interest in enforcing the obligation to complete the works as a whole.[166]

Another factor which the courts have referred to post-*Cavendish* is whether the purported penalty clause is in line with industry standards and market rates. For example, in *GPP Big Field LLP* v *Solar EPC Solutions SL (Formerly Prosolia Siglio XXI)* the court referred to the fact that delay damages provisions of that kind were common in construction contracts.[167] Market rates for interest for loans have also been particularly relevant after *Cavendish*.[168] It has also been held that evidence would be required to

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[159] Rowan (n 7) at 165; *Signia Wealth Ltd* v *Vector Trustees Ltd* [2018] EWHC 1040 (Ch) at para 653 per Marcus Smith J.
[160] *Cavendish Square Holding BV* v *Makdessi*; *ParkingEye Ltd* v *Beavis (Consumers’ Association Intervening)* [2015] UKSC 67, [2016] AC 1172 at paras 272-274 per Lord Hodge.
[161] *Cavendish* at para 274 per Lord Hodge.
[162] *Cavendish* at para 274 per Lord Hodge.
[163] Rowan (n 7) at 164.
[164] *Vivienne* at para 53 per Timothy Fancourt QC.
[165] *Eco World – Ballymore Embassy Gardens Co Ltd* v *Dobler UK Ltd* [2021] EWHC 2207 (TCC) at para 80 per O’Farrell J.
[166] *Eco World* at para 80 per O’Farrell J.
[167] *GPP Big Field LLP* v *Solar EPC Solutions SL (Formerly Prosolia Siglio XXI)* [2018] EWHC 2866 (Comm) at para 67 per Richard Salter QC.
[168] *Cargill International Trading Pte Ltd* v *Uttam Galva Steels Ltd* [2019] EWHC 476 (Comm) at paras 54 and 56 per Bryan J; *Ahuja Investments Ltd* v *Victorygame Ltd* [2021] EWHC 2382 at para 144 per Hodge

justify an interest rate "completely out of line with commercial norms."[169] Otherwise, the rate stipulated would be held to be a penalty.[170]

Additionally, the courts have taken into consideration the identity of the parties when applying the legitimate interest test.[171] Having regard to the "strong initial presumption" that commercial parties are best placed to decide whether an interest is legitimate, subsequent decisions applying the legitimate interest test have placed weight on the identity of the parties as sophisticated entities acting on legal advice.[172] The consideration of industry standards and market rates as well as the presumption where the parties are commercial in nature both demonstrate the ongoing influence of the commercial justification cases post-*Cavendish*.

To summarise, despite criticism that the legitimate interest test as established by *Cavendish* lacks clarity, this subsection has distilled a number of relevant factors from subsequent English cases which are relevant when applying the legitimate interest test. Two intertwined factors are the importance of the stipulation to the contract and the severity of the consequences for breach. In a commercial context, the courts will consider the characteristics of the parties and give effect to the presumption that they should be hesitant to intervene, and compare stipulations with industry standards and market rates. In *Cavendish*, the Supreme Court also explicitly identified public interest as pertinent to the question of whether the stipulation protected a legitimate interest. Subsequent cases have focused on the commercial applications of the penalty doctrine, so further analysis of the public interest awaits future cases. Finally, the post-*Cavendish* cases have potentially developed a new step in applying the penalty doctrine, which is to filter out simpler cases with the traditional genuine pre-estimate of loss test. This accords with the ongoing role the Supreme Court envisaged for *Dunlop* in *Cavendish*.

(4) The proportionality requirement

Having examined the legitimate interest requirement, this section will analyse the proportionality test: (i) what must the stipulation be proportionate to, and (ii) what level of tolerance is accepted when assessing whether the stipulation is proportionate?[173] As

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QC; *Bank of Beirut (UK) Ltd* v *Moukarzel Nabil* [2021] EWHC 3777 (Comm) at para 61 per Sean O'Sullivan QC.

[169] *First Personnel Services Limited* v *Halfords Limited* [2016] EWHC 3220 (Ch) at para 163 per Jeremy Cousins QC.

[170] *First Personnel* at para 163 per Jeremy Cousins QC.

[171] Rowan (n 7) at 172-173; *BHL* v *Leumi ABL Limited* [2017] EWHC 1871 (QB) at paras 44-45 per Wakesman QC; *European Film Bonds AS* v *Lotus Holdings LLC* [2020] EWHC 1115 (Ch) at para 167 per Andrew Hochhauser QC.

[172] *Cavendish* at para 35 per Lords Neuberger and Sumption.

[173] Worthington (n 138) at 149.

with the previous section, this section will start by considering the commercial justification cases which predate *Cavendish* since they provide useful illustrations of the approach taken to the proportionality assessment. The second part will scrutinise the way in which the courts have applied the proportionality condition post-*Cavendish*.

(a) The commercial justification cases

Broadly speaking, two main approaches were taken to proportionality in the commercial justification cases. The first approach was Arden LJ's approach in *Murray*: to compare the amount stipulated for with the amount that would be payable "if a claim for damages for breach of contract was brought under common law".[174] If the sum was found not to be a genuine pre-estimate of loss, the next step was to determine whether there was a commercial justification for the discrepancy between the amount stipulated for and the amount that would be payable in damages.[175]

On the other hand, Buxton LJ (whose approach Clarke LJ preferred) criticised this approach as too "rigid" and stated that a discrepancy with the amount of damages available at common law would not necessarily mean that the stipulation was penal.[176] Instead, Buxton LJ quoted Lord Dunedin's statement with approval, which was that the stipulation would be a penalty if it was "extravagant and unconscionable […] in comparison with the greatest loss that could conceivably be proved to have followed from the breach".[177]

In the commercial justification cases, the courts compared the stipulations to (a) the amount of loss resulting from breach, or (b) the greatest potential loss. This was because the test was still whether the clause was a genuine pre-estimate of loss and this illustrates how the question of whether a stipulation is proportionate ultimately revolves around the interest that it must be proportionate to.[178]

Another noteworthy feature of the commercial justification cases was that the proportionality question was relevant to determining whether the interests were compensatory. For example, in *Lordsvale*, Colman J found that where there was a discrepancy between the stipulated sum and the potential amount of loss resulting from breach, the function was likely to be deterrence, rather than compensation.[179] This

[174] *Murray* v *Leisureplay Plc* [2005] EWCA Civ 963 at para 54 per Arden LJ.
[175] *Murray* at para 54 per Arden LJ.
[176] *Murray* at paras 114 and 116 per Buxton LJ.
[177] *Murray* at para 114 per Buxton LJ; *Dunlop Pneumatic Tyre Company* v *New Garage and Motor Company* [1915] AC 79 at 87 per Lord Dunedin.
[178] Worthington (n 138) at 149.
[179] *Lordsvale Finance Plc* v *Bank of Zambia* [1996] 3 WLR 688, [1996] QB 752 at 762 per Colman J.

further demonstrates the intertwined nature of the permitted interests and the proportionality test.

However, at Court of Appeal level in *Cavendish*, the approach taken by the court went a step further. Christopher Clarke LJ deemed the provision to be "extravagant" but held that this was not "conclusive."[180] This was because the Court of Appeal considered whether the clause could be justified by reference to commercial interests. Thus, the commercial justification approach appears to have supplanted the compensatory proportionality analysis, rather than co-existing with it as it did in the *Lordsvale* approach.

(b) The post-Cavendish cases

After *Cavendish*, the question before the courts is whether the provisions are proportionate compared to the legitimate interest of the party seeking to enforce them.[181] Yet, in *Cavendish*, Lords Neuberger and Sumption also stated that in "straightforward" cases the innocent party's interest will "rarely extend beyond compensation for breach" in which case "Lord Dunedin's four tests would usually be perfectly adequate to determine [the] validity" of the particular provision.[182] This illustrates the interconnected nature of the relevant interest protected and the question of proportionality.

However, in some of the cases post-*Cavendish* the courts have continued to compare stipulations to the loss suffered by the innocent party.[183] This is despite the fact that the innocent party may have a commercial interest in enforcing the provision.[184] For instance, *Hayfin Opal Luxco 3 SARL* v *Windermere VII CMBS Plc* concerned the interest of commercial entities in enforcing a particular interest rate after breach in the context of a loan agreement, and it was seemingly accepted that there was a legitimate interest in imposing interest rates to ensure prompt repayment.[185] Nevertheless, Snowden J concluded (*obiter*) that the sum was "exorbitant" as the stipulation was for a sum "many times the amount that would adequately compensate the innocent party."[186]

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[180] *Makdessi* v *Cavendish Square Holdings BV* [2013] EWCA Civ 1539 at paras 117 and 124 per Christopher Clarke LJ).
[181] *Cavendish* at para 32 per Lords Neuberger and Sumption; para 152 per Lord Mance; para 255 per Lord Hodge.
[182] *Cavendish* at para 32 per Lords Neuberger and Sumption.
[183] *Eco World* at para 82 per O'Farrell J; *Vivienne Westwood Ltd* at para 63 per Timothy Fancourt QC; *Hayfin Opal Luxco 3 SARL* v *Windermere VII CMBS Plc* [2016] EWHC 782 (Ch), [2018] 1 BCLC 118 at para 140 per Snowden J.
[184] *Eco World* at para 82 per O'Farrell J; *Vivienne Westwood* at para 63 per Timothy Fancourt QC; *Hayfin* at para 140 per Snowden J.
[185] *Hayfin* at paras 136 and 138 per Snowden J.
[186] *Hayfin* at para 140 per Snowden J.

Given that Snowden J accepted the legitimate commercial interest in prompt repayment of a loan, the proportionality question should have been considered in light of that commercial interest. The reference to compensation for the proportionality test was inappropriate. Snowden J also followed the pre-*Cavendish* approach that a provision would still be a penalty even if in an "exceptional and improbable case" the amount stipulated for would not exceed the loss from breach.[187]

The entwined nature of the legitimate interest and proportionality aspects of the new conception of the penalty doctrine is further illustrated by other cases post-*Cavendish* which focus on applicable market rates when applying both stages of the test.[188] For example, in *Bedford Investments Ltd* v *Sellman*, Pearce J stated that the questions of whether the provision enforced a legitimate interest and whether it was proportionate depended on "the circumstances in which the contract was agreed" and the "standard market rates."[189]

Furthermore, the 'strong initial presumption' which applies where parties were of equal bargaining power and received legal advice are other relevant factors in the proportionality assessment.[190] Halson contended that where the presumption applies, there must be a greater disparity between the benefit provided and the legitimate interest before a provision will be found to be a penalty.[191] Consequently, the characteristics of the parties to the contract affect the degree of tolerance afforded by the courts before a stipulation will be found to be a penalty, as well as being a relevant consideration for the purposes of determining whether the party seeking to enforce the clause had a legitimate interest.

There are three main criticisms which can be applied to this approach. If market rates are the most important source of evidence for both the legitimate interest and proportionality requirements as contended by Bryan J in *Cargill*, this could render the proportionality assessment redundant. If the existence of comparative market rates indicates a legitimate commercial interest, could it ever subsequently be concluded that the stipulated interest rate was disproportionate? The other problem with judicial emphasis of market rates is that it assumes that the market rates themselves are not punitive, yet this is not necessarily the case.

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[187] *Hayfin* at para 138 per Snowden J; *Cooden Engineering* v *Stanford* [1953] 1 QB 86 at 98 per Somervell LJ.
[188] *Bedford Investments Ltd* v *Sellman* [2021] EWHC 799 (Comm) at para 40 per Pearce J; *Cargill* at para 56 per Bryan J.
[189] *Bedford* at para 40 per Pearce J.
[190] Halson (n 143) para 2.51.
[191] Halson (n 143) para 2.51.

Another critique of the *Cavendish* reformulation of the penalty doctrine is that the discretion it affords to judges renders it a value judgement.[192] The discretion also affects the degree of tolerance that will be afforded to the party relying on the stipulation during the proportionality assessment. For example, in *Permavent* v *Makin*, Zacaroli J described the relevant stipulation as "extremely harsh" but nonetheless found that it was proportionate to the claimants' legitimate interest.[193] It is difficult to see how a provision could be described as "extremely harsh" without falling into the realm of extravagance – exactly where the penalty doctrine is supposed to apply.

Ultimately, as this section demonstrates, the type of the interest which will be protected in contractual provisions necessarily transforms the nature of the proportionality assessment to be carried out. As with the legitimate interest test, the influence of the commercial justification cases is felt in the post-*Cavendish* approach to proportionality, particularly with respect to the weight placed upon market rates and the initial presumption where parties are of equal bargaining power. Nevertheless, even in subsequent commercial cases the courts have continued to have regard to the loss suffered by the party seeking to enforce a stipulation.

(5) Conclusion

Overall, this chapter has identified the key features of the new approach to the penalty doctrine from the judgements in *Cavendish*, and explored the requirements of the legitimate interest test with reference to the commercial justification cases and the decisions after *Cavendish*. A number of factors have been highlighted as relevant: the significance of the stipulation to the contract, the severity of consequences for breach, the characteristics of the parties, and comparison with industry standards and market rates. The public interest is also a pertinent consideration, but this point awaits further development in decided case law.

Furthermore, the intertwined nature of the legitimate interest and proportionality elements of the modern approach has been emphasised, including considerations which will be relevant to both stages of the test, and some criticisms have been levelled as a result. It seems clear that both stages will accord the terms of the contract a wider degree of deference in cases where the parties are of a commercial character.

Finally, the post-*Cavendish* cases have continued to have regard to the traditional genuine pre-estimate of loss test. This aligns with the ongoing role the Supreme Court

[192] O Barron, "The Penalty Doctrine: Reformulating New Zealand's Regime Against Penalty Clauses" (2018) Victoria University of Wellington Legal Research Paper, Student/Alumni Paper No 30/2018, 16.
[193] *Permavent* v *Makin* [2021] EWHC 467 (Ch) at paras 78-79 per Zacaroli J.

envisaged for *Dunlop* in *Cavendish* in respect of simpler cases, although there is room for refinement regarding the interaction of the traditional and modern tests.

D. CHAPTER IV - ANALYSIS OF THE DIFFERENCES BETWEEN *CAVENDISH* AND THE PRIOR SCOTS LAW

Having described both the previous conception of the penalty doctrine in Scots law, and the new *Cavendish* formulation, this chapter will investigate the degree to which *Cavendish* marks a departure from the orthodox Scottish approach to the penalty doctrine. Chapter VII will argue that *Cavendish* is persuasive in Scots law, but likely to be followed.[194] Consequently, this chapter questions the extent to which *Cavendish* will transform Scots law.

To answer this question, this chapter begins by considering the precedents relied upon by the Supreme Court to evaluate the extent to which *Cavendish* illustrates continuity with the historical cases. Finally, similarities and changes will be identified, with reference to three main principles which influenced the Supreme Court's approach to reform.

(1) Critique of the historical analysis in *Cavendish*

When evaluating the degree of change caused by *Cavendish*, it is useful to highlight the Supreme Court's analysis of precedents. In *Cavendish*, the Supreme Court acknowledged that Lord Dunedin's judgment in *Dunlop* was so well-established that it had achieved the status of a "quasi-statutory code."[195] Rather than explicitly overrule *Dunlop*, the Supreme Court sought to recast *Dunlop* by emphasising Lord Atkinson's judgment.[196] In *Cavendish*, the Supreme Court also referred to Lord Robertson's opinion in *Clydebank* to contend that historic cases had permitted recovery for non-compensatory interests.[197] In this way, the Supreme Court's analysis of the key 19th century cases enabled them to present the new legitimate interest test as broadly continuous with precedent, despite diverging from Lord Dunedin's classic dictum. This section criticises the Supreme Court's interpretation of the judgments from Lords Robertson and Atkinson in order to argue that *Cavendish* represented a significant change in the approach to the penalty doctrine for Scots law.

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[194] Discussion Paper on *Penalty Clauses* (Scot Law Com No 162, 2016) para 1.7.
[195] *Cavendish* at para 22 per Lords Neuberger and Sumption.
[196] Worthington (n 138) at 134.
[197] *Cavendish* at para 22 per Lords Neuberger and Sumption.

According to Lords Neuberger and Sumption, the question raised in the opinions of both Lord Robertson and Lord Atkinson was: “what was the nature and extent of the innocent party’s interest in the performance of the relevant obligation”, noting that “that interest was not necessarily limited to mere […] compensation.”[198] However, looking at the dicta, it is difficult to see how Lords Neuberger and Sumption came to the conclusion that the interest was not limited to compensation.

In *Clydebank*, Lord Robertson found that the question was whether the respondents had “no interest to protect by that clause, or was that interest palpably incommensurate with the sums agreed on?”[199] This formulation of the penalty doctrine appears to turn on the same legitimate interest and proportionality requirements as we find in *Cavendish*. Yet, the rest of Lord Robertson’s opinion clarifies the nature of the relevant interest. Lord Robertson also approved of Lord Moncreiff’s reference to the difficulties of conducting a proof of the damage the pursuers had suffered, and the “loss” they had suffered was difficult to calculate.[200] Consequently, while Lord Robertson’s reference to an “interest” is ambiguous, the approval of Lord Moncreiff’s reference to “loss” is illuminating.

Similarly, in *Dunlop*, Lord Atkinson stated that the court needed to consider whether the sum was stipulated in terrorem, or whether it was “genuinely a pre-estimate of the appellants’ probable or possible interest in the due performance of the contract.”[201] However, Lord Atkinson also stated that in terms of “direct and immediate loss the appellants [lost] nothing” but went on to find that they would suffer a “consequential injury to their trade” due to undercutting, and that they had an “obvious interest” in preventing the undercutting.[202] From a compensatory analysis, the appellants’ interest was in preventing undercutting, and due to the defender’s breach of their obligations, the appellants had suffered consequential injury to their trade. As a result, on a closer analysis, the opinions of both Lord Robertson and Lord Atkinson appear to support a compensatory view of liquidated damages clauses which aligns with contemporary precedent, but which is inconsistent with the legitimate interest test in *Cavendish*. Consequently, this evaluation undermines the Supreme Court’s attempt to ground the legitimate interest test in Scottish authority.

(2) The case for change in *Cavendish*

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[198] *Cavendish* at para 23 per Lords Neuberger and Sumption.
[199] *Clydebank Engineering and Shipbuilding Company, Limited* v *Don Jose Ramos Yzquierdo Y Castaneda* [1905] AC 6 at 20 per Lord Robertson.
[200] *Clydebank* at 20 per Lord Robertson.
[201] *Dunlop Pneumatic Tyre Company* v *New Garage and Motor Company* [1915] AC 79 at 96 per Lord Atkinson.
[202] *Dunlop* at 91-92 per Lord Atkinson.

Having decided against abrogation of the penalty doctrine, the Supreme Court turned to reform.[203] Central to understanding the *Cavendish* reformulation are the principles briefly identified in chapter III: freedom of contract, certainty, and commercial considerations.[204] It is important to establish from the outset that these principles are intertwined: for example, if the courts refuse to interfere with contracts to support parties' freedom of contract, this will result in greater certainty of outcomes for the contracting parties. This section considers the way in which these principles influenced the reformulation of the penalty doctrine in *Cavendish*.

(a) Continuity after Cavendish

As established in chapter II, the orthodox conception of the penalty doctrine did recognise the significance of these three principles. For example, the accepted function of liquidated damages clauses was to provide parties with certainty about remedies on breach and enable them to avoid expensive and time-consuming litigation. Thus, the motivation for change in *Cavendish* may be understood as one of shifting priorities, rather than the introduction of entirely new considerations.

Commercial concerns were clearly at the forefront of the Supreme Court's concerns in *Cavendish*, whereas a more moderate approach was taken in *Dunlop*. This is exemplified by the introduction of the "strong initial presumption" that parties who have the benefit of legal advice and are of equal bargaining power were best placed to determine stipulations for breach.[205]

Another example of relatively minor change is the proportionality requirement set out in *Cavendish*. As in *Dunlop*, the Supreme Court in *Cavendish* used (amongst other terms) the words "extravagant and unconscionable".[206] Despite the same language being used, *Cavendish* has changed the proportionality assessment. It is now to be made with reference to the pursuer's legitimate interest, and no longer is the greatest possible loss to be used as a yardstick.[207] The result is to lower the threshold so that stipulations are less likely to be held to be unenforceable penalties. This could also be demonstrative of a greater emphasis being placed on any of the three fundamental principles. Ultimately, the proportionality assessment prescribed by *Cavendish* broadly performs a similar

[203] *Cavendish* at para 39 per Lords Neuberger and Sumption; para 162 per Lord Mance; para 256 per Lord Hodge.
[204] *Cavendish* at para 33 per Lords Neuberger and Sumption); paras 144-145 per Lord Mance; paras 225 and 248 per Lord Hodge.
[205] *Cavendish* at paras 35 and 43 per Lord Neuberger and Sumption.
[206] *Dunlop Pneumatic Tyre Company* v *New Garage and Motor Company* [1915] AC 79 at 87 per Lord Dunedin; *Cavendish* at para 32 per Lords Neuberger and Sumption; para 152 per Lord Mance; para 255 per Lord Hodge.
[207] *Cavendish* at para 255 per Lord Hodge.

function to the *Dunlop* assessment: it provides a cap that enables the courts to prevent "extortionate" sanctions. Therefore, it seems more like an adjustment of degree rather than an alteration to the substance of the requirement.

(b) Change after Cavendish

Arguably, the greatest difference between Cavendish and the traditional formulation of the penalty doctrine was the new approach taken to freedom of contract. There is an inherent tension between freedom of contract and the penalty doctrine; the existence of the penalty doctrine has been subject to significant judicial and academic criticism due to this incompatibility.[208] Freedom of contract was the cornerstone of the reasoning in Cavendish.[209] This is illustrated by the change represented by the introduction of the legitimate interest test and rejection of the exclusive dichotomy between genuine pre-estimates of damage and penalty clauses.[210]

As set out in chapter II, the historic justification for the penalty doctrine in Scotland was that parties could not enforce a stipulation designed to punish the other party.[211] Likewise, in *Cavendish*, penal provisions were also held to be unenforceable.[212] However, departing from the traditional approach, the Supreme Court also held that deterrent provisions could be enforced if they were not penal.[213] The effect was to restrict the ability of courts to interfere with freedom of contract. The problem with this approach is that there is significant difficulty in distinguishing between deterrence and punishment.[214]

Day has contended that a deterrence clause is necessarily a penalty clause because the purpose of punishment is to deter wrongdoing.[215] According to Day, the available damages act as an "anchor" to the liquidated damages clause, and if the sum stipulated for is disproportionate relative to damages, the liquidated damages clause will not be enforced.[216] Under Day's analysis, it is the difference between the available damages and the liquidated damages clause which acts as the deterrent to breach of contract.[217]

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[208] *Makdessi* v *Cavendish Square Holdings* [2013] EWCA Civ 1539 at para 44 per Christopher Clarke LJ; *Robophone Facilities Ltd* v *Blank* [1966] 1 WLR 1428 at 1446 per Diplock LJ; S Worthington, "Common Law Values: The Role of Party Autonomy in Private Law", in A Robertson and M Tilbury (eds), *The Common Law of Obligations: Divergence and Unity* (2015) 439 at 454-456.
[209] *Cavendish* at paras 35 and 43 per Lord Neuberger and Sumption.
[210] *Cavendish* at para 145 per Lord Mance; para 225 per Lord Hodge.
[211] *Craig* v *M'Beath* (1863) 1 M. 1020, 1022 (Lord Justice-Clerk Inglis).
[212] *Cavendish* at para 31 per Lords Neuberger and Sumption.
[213] *Cavendish* at para 28 per Lords Neuberger and Sumption; para 152 and 198 per Lord Mance; para 248 Lord Hodge.
[214] W Day, "Penalty Clauses Revisited" (2014) (6) Journal of Business Law 512 at 516.
[215] Day (n 96) at 236.
[216] Day (n 96) at 228.
[217] Day (n 96) at 228.

Consequently, he has concluded that under the Cavendish formulation, only disproportionate penalties are unenforceable and other penalties will be enforced by the courts.[218] Previously, Day argued against enforcing deterrent provisions on the basis that it would constitute a step towards recognising the right of commercial entities to "construct a system of private sanctions."[219] This raises the question of whether parties should ever be permitted to agree to a remedy that would not be available in court.[220]

The other problem with the new *Cavendish* approach is the normative question of whether punishment is ever justifiable for breach of contract. For example, Morgan has questioned whether penal clauses are a real problem.[221] As outlined, the traditional Scottish approach was that penalty clauses were unenforceable because parties cannot enter into an agreement that one party can be punished by the other; this aligns with the orthodox view that damages are purely compensatory.[222] As a result, it is clear that the recognition of deterrence as a legitimate interest is a dramatic conceptual change for Scots contract law. It may have the inadvertent effect of awarding punitive damages.

(3) Conclusion

Overall, although the Supreme Court in Cavendish aimed to ground the reformulation of the penalty doctrine in precedent, their interpretation of Lords Robertson and Atkinson's opinions appears incorrect. Rejecting abrogation of the penalty doctrine, the Supreme Court opted for reform, seemingly grounded by a focus on the principles of freedom of contract, certainty, and commercial reality. Some changes can be viewed as relatively minor, such as lowering the threshold of the proportionality assessment. On the other hand, the introduction of the legitimate interest test marks a radical departure from existing Scots authority, and could be construed as directly undermining the established purpose of the penalty doctrine.

E. CHAPTER 5 - IS THERE A GENERAL CONCEPT OF 'LEGITIMATE INTEREST' IN SCOTS CONTRACT LAW?

Having set out the criticisms of the Supreme Court's approach to defining the new legitimate interest requirement in *Cavendish* in chapter IV, this chapter places legitimate interest in its Scottish context, assessing whether it relates to ideas of 'legitimate

[218] Day (n 96) at 236.
[219] Day (n 214) at 516.
[220] Day (n 96) at 228.
[221] J Morgan, "The Penalty Clause Doctrine: Unlovable but Untouchable" (2016) 75(1) Cambridge Law Journal 11 at 12.
[222] *Craig* at 1022 per Lord Justice-Clerk Inglis; *Teacher* v *Calder* [1899] AC 451 at 468 per Lord Davey.

interest' which we can see at work in other parts of Scots contract law. In *Cavendish*, Lords Neuberger and Sumption stated the "availability of remedies for a breach of duty is not simply a question of providing a substitute for performance."[223] They argued that remedies would not be available where "the adverse impact […] on the defaulter significantly exceeds any legitimate interest of the innocent party."[224] As support for their proposition, Lords Neuberger and Sumption identified the doctrine of specific performance and the case of *White & Carter (Councils) Ltd* v *McGregor* as examples of the legitimate interest doctrine.[225] Consequently, other authors have naturally turned to these areas of contract law for guidance in interpreting *Cavendish*.[226]

However, the majority of existing works are written from an English perspective; at the date of writing, there is no detailed analysis of whether there is a general principle of legitimate interest in Scots contract law. This is important because specific performance is an English remedy distinct from the closest Scottish equivalent of specific implement. Scottish authors have been careful to distinguish both remedies, so it is interesting to consider whether there is a shared concept of legitimate interest notwithstanding those differences.[227] From a Scottish perspective, the reference to *White* also demands analysis given its status as a Scottish appeal to the House of Lords which has been treated as authoritative in both Scots and English law. This chapter will consider whether the subsequent interpretations by the English and Scottish courts have been consistent. Thus, this chapter will start by comparing specific performance with specific implement, before moving on to consider both the Scottish and English case law following *White*.[228]

(1) Specific relief

(a) Specific performance

Specific performance is an equitable remedy available under English law to allow the claimant to enforce the defendant's positive obligations.[229] Generally, negative obligations are enforced via injunctions.[230] Specific relief is ultimately enforceable with

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[223] *Cavendish* at para 29 per Lords Neuberger and Sumption.
[224] *Cavendish* at para 29 per Lords Neuberger and Sumption.
[225] *Cavendish* at paras 29-30 per Lords Neuberger and Sumption.
[226] Rowan (n 7) at 156; *Chitty on Contracts* 35th edn paras 30-230 and 30-232.
[227] L Macgregor, "Specific Implement in Scots Law" in J Smits, D Haas, and H GG (eds), *Specific Performance in Contract Law: National and Other Perspectives* (2008) 67 at 88; David Hope, "Specific Implement and Specific Performance: Are They Really Much the Same?", in Simone Degeling, James Edelman and James Goudkamp (eds), *Contract in Commercial Law* (2016) 313 at 319.
[228] *White & Carter (Councils) Ltd* v *McGregor* 1962 SC (HL) 1.
[229] A Burrows, *Remedies for Torts, Breach of Contract, and Equitable Wrongs* (2019) 401.
[230] E Yorio and S Thel, *Contract Enforcement: Specific Performance and Injunctions,* 2nd edn (2011) para 1.2.2.

imprisonment.[231] Specific performance is described as an "equitable" remedy as it originated from the equitable Court of Chancery prior to the fusion with the common law courts.[232] Specific performance is also considered an "exceptional remedy" because it was historically awarded under the Court of Chancery's discretionary jurisdiction "to do justice" where "the remedies available at common law were inadequate."[233] Traditionally, the "general principle" is that "specific performance will not be ordered where damages are an adequate remedy."[234] This is because in English law, parties only had a legal right to common law damages.[235] Damages are a "substitute for performance" which is why they are generally an "adequate remedy."[236] The courts will not prevent breach of contract "where the interests of the innocent party can be adequately protected by […] damages."[237]

Academics have expressed this general principle differently. McKendrick contended that the courts "do not spell out the circumstances in which damages are an adequate remedy."[238] Instead, the courts "identify the circumstances in which damages are inadequate."[239] Thus, Burrows stated that "specific performance will not be ordered unless damages (and the common law remedy of the award of an agreed sum) are inadequate."[240] Importantly, the court can still exercise its discretion and refuse to award specific performance even where damages are an inadequate remedy.[241]

However, the general principle that damages must not be an adequate remedy before specific performance can be awarded has "come under challenge in recent years."[242] McKendrick identifies the House of Lords case *Beswick* v *Beswick* as the starting point for the transformation of the English approach.[243] In *Beswick*, the majority found that only nominal damages would be available. Yet, Lord Pearce held that "damages, if assessed, must be substantial. It is not necessary, however, to consider the amount of damages more closely since […] the more appropriate remedy is that of specific performance."[244] *Beswick* was seen as a dramatic change that would give parties the choice between damages and specific performance.[245] Furthermore, in subsequent

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[231] S14(1) Contempt of Court Act 1981; *Co-Operative Insurance Society Limited* v *Argyll Stores (Holdings) Limited* [1998] AC 1, at 12-13 per Lord Hoffmann.
[232] Burrows (n 229) 10 and 401.
[233] *Co-Operative Insurance* at 11 per Lord Hoffmann.
[234] *Co-Operative Insurance* at 11 per Lord Hoffmann.
[235] *Co-Operative Insurance* at 11 per Lord Hoffmann.
[236] *Morris-Garner* v *One Step (Support) Ltd* [2018] UKSC 20, [2019] AC 649 at para 35 per Lord Reed.
[237] *Morris-Garner* at para 35 per Lord Reed.
[238] Ewan McKendrick, *Contract Law: Text, Cases and Materials,* 10th edn (2022) 902.
[239] McKendrick (n 238) 902.
[240] Burrows (n 229) at 402.
[241] McKendrick (n 238) 903.
[242] McKendrick (n 238) 903.
[243] McKendrick (n 238) 915; *Beswick* v *Beswick* [1968] AC 58.
[244] *Beswick* at 88 per Lord Pearce.
[245] F Lawson, *Remedies of English Law,* 2nd edn (1980) 223-224.

cases it was held that the requirements of justice and good conscience overrode the general principle that damages must not be an adequate remedy before specific performance will be available.[246] Therefore, McKendrick concluded that the law is in a "state of flux" and that the courts are no longer restricted to considering whether damages would be an adequate remedy before specific performance could be granted, although it remains "a very important factor."[247]

However, Burrows has argued that these cases do not represent a dramatic shift in the law as they have not resulted in a "substantive change" in the test applied by subsequent cases.[248] The trend in the Supreme Court's judgments has been a return to the orthodox formulation: where damages would not provide an adequate remedy, specific performance can be granted.[249] In *Cavendish*, Lords Neuberger and Sumption stated that "the minimum condition for an order of specific performance is that the innocent party should have a legitimate interest attending beyond pecuniary compensation for the breach."[250] *Cavendish* has been described as an alternative formulation expressing the same traditional principle.[251] Consequently, Burrows has concluded that, notwithstanding *Beswick*, the requirement that damages must be inadequate before specific performance will be available for breach of contract has prevailed.[252]

(b) Specific implement

Specific implement is the Scottish remedy which compels performance of contractual obligations.[253] Interdict is the Scottish remedy which prohibits actions, although the practical effects of these orders may differ.[254] Like specific performance, specific implement is ultimately enforceable with imprisonment.[255] In Scots law, a party has a legal right to specific implement as a remedy for breach of contract. The most famous dictum on this point comes from Lord Watson, in *Stewart* v *Kennedy*, who held the

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[246] *CN Marine Inc* v *Stena Line A/B ("The Stena Nautica")* (No.2) [1982] 2 Lloyd's Rep 336, at 346– 347 per May LJ; *Anders Utkilens Rederi A/ S* v *O/ Y Lovisa Stevedoring Co A/ B* [1985] 2 All ER 669 at 674 per Goulding J; *Rainbow Estates Ltd* v *Tokenhold Ltd* [1999] Ch 64 at 73 per Lawrence Collins QC.
[247] McKendrick (n 238) 903.
[248] Burrows (n 229) 411.
[249] *Guest* v *Guest* [2022] UKSC 27 at para 201 per Lord Briggs; *Wolverhampton City Council* v *London Gypsies and Travellers* [2023] UKSC 47 at para 105 per Lord Reed; *Tesco Stores Ltd v Union of Shop, Distributive and Allied Workers* [2024] UKSC 28 at para 73 per Lord Burrows.
[250] Edwin Peel, *Treitel on the Law of Contract*, 15th edn (2020) para 21-019.
[251] *Chitty on Contract* paras 31-018; Peel (n 250) para 21-019.
[252] Burrows (n 229) 402 and 410-411.
[253] McBryde, *Contract* para 23-01.
[254] McBryde, *Contract* paras 23-01-23-02.
[255] *Highland and Universal Properties Ltd* v *Safeway Properties Ltd* 2000 SC 297 at 302 per Lord President Rodger; the common law was amended by s1(1)(i) Law Reform (Miscellaneous Provisions) (Scotland) Act 1940.

"aggrieved party [has] the legal right to sue for implement, and although he may elect to do so, he cannot be compelled to resort to […] damages unless implement is shewn to be impossible".[256] Yet, Lord Watson also found that the Court of Session had an "inherent power to refuse the legal remedy upon equitable grounds" where circumstances would render enforcing performance "inconvenient and unjust."[257] The defender bears the onus of arguing against an award of specific implement, and must provide "cogent reasons" for doing so.[258] As a result, specific implement has been described as a pursuer's "primary" remedy.[259] This view has been criticised by McBryde for a number of reasons: specific implement is uncommon in practice, discretionary, may be inappropriate/incompetent, pursuers have the right to elect between specific implement/damages, and Scots law has a cumulative system of remedies.[260] Consequently, he contends that modern Sots law "does not have a hierarchy of remedies."[261]

Nevertheless, even if McBryde's argument that specific implement should not be considered a pursuer's primary remedy is accepted, there is a clear difference between specific implement and specific performance. As established in the previous section, the general principle of English law is that specific performance can only be granted if damages are not an adequate remedy. In contrast, in Scots law, the pursuer has a legal right to specific implement. This suggests there is a meaningful difference between specific performance and specific implement.

However, whether there is a substantive difference between specific performance and implement has been subject to debate. Scottish authors have tended to argue that there is a meaningful difference between the two remedies, whereas some English authors have suggested otherwise.[262] In *Co-Operative Insurance Society Limited* v *Argyll Stores (Holdings) Limited*, Lord Hoffmann acknowledged that specific performance was not available "when damages are an adequate remedy" whereas "in countries with legal systems based on civil law, such as […] Scotland, the plaintiff is prima facie entitled to specific performance."[263] Despite that, Lord Hoffmann claimed that "[i]n practice, however, there is less difference […] than these general statements might lead one to

[256] *Stewart* v *Kennedy (No 1)* (1890) 17 R (HL) 1 at 10 per Lord Watson.
[257] *Stewart* at 10 per Lord Watson.
[258] *Grahame* v *Magistrates of Kirkcaldy* (1882) 9 R (HL) 91 at 91-92 per Lord Watson.
[259] H L MacQueen and L Macgregor, 'Specific Implement, Interdict and Contractual Performance' (1999) 3(2) Edinburgh Law Review 127 at 127.
[260] McBryde, *Contract* para 23-08.
[261] McBryde, *Contract* para 23-08.
[262] Macgregor (n 227) at 88; Hope (n 227) at 319; E McKendrick, "Specific Implement and Specific Performance – A Comparison" (1986) Scots Law Times (News) 249 at 250; *Co-Operative Insurance* at 11-12 per Lord Hoffmann.
[263] *Co-Operative Insurance* at 11 per Lord Hoffmann.

suppose."[264] Lord Hoffmann stated that across Civil Law and Common Law systems he "would expect that judges take much the same matters into account in deciding whether specific performance would be inappropriate."[265] If there was an erosion of the general principle that specific performance is only available where damages would not be an adequate remedy, the doctrine relating to specific performance would become more similar to specific implement. Yet, it appears that the general principle has been reaffirmed by recent Supreme Court cases, including *Cavendish*. Therefore, it is difficult to see how Lord Hoffmann can be correct in concluding that in practice there is not much difference between specific performance and specific implement.

The distinct approaches to damages taken by English and Scots contract law reflect the fundamental difference between the legal systems in both jurisdictions as outlined by Lord Hoffmann. The preeminent theory for Scots contract law is will theory, reflecting its status as a mixed legal system and a clear manifestation of civilian influence.[266] Will theory is an example of a rights-based theory, and is premised on the idea that contracts are enforceable as the parties consented to bind themselves.[267] This is exemplified by the principle *pacta sunt servanda*, famously translated by Stair as "every paction produceth action."[268] Practically, this results in a far greater protection of the performance interest through greater availability of remedies such as specific implement and the right to insist on performing following repudiation. Further evidence of the practical importance of this theoretical distinction is the fact that promises without consideration are legally binding in Scots law but not English law.[269]

In contrast, while will theory remains the dominant basis of English contract law, there are a number of proponents of the efficient breach theory.[270] According to the theory of efficient breach, breach of contract should be encouraged where it is more economically efficient because the defendant is still better off after compensating the claimant (who is no worse off).[271] Some aspects of English contract law are more consistent with the theory of efficient breach: for example, the fact that promises are not enforceable, specific performance only being available where damages would not provide an adequate remedy, and the doctrine of mitigation. Consequently, it is contended that from

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[264] *Co-Operative Insurance* at 11 per Lord Hoffmann.
[265] *Co-Operative Insurance* at 11-12 per Lord Hoffmann.
[266] M Hogg, "Perspectives on Contract Theory from a Mixed Legal System" (2009) 29(4) Oxford Journal of Legal Studies 643 at 643; S A Smith, *Contract Theory* (2004) 46-48.
[267] Smith (n 266) 47-48.
[268] Stair, *Institutes*, 1.10.7; H L MacQueen, "Scots and English Law: The Case of Contract" (2001) 54 Current Legal Problems 205 at 217.
[269] Hogg (n 266) at 660; *Ashia Centur Ltd* v *Barker Gillette LLP* [2011] EWHC 148 (QB), at para 20 per Tugendhat J.
[270] Smith (n 266) 48; D Campbell and P Wylie, "Ain't No Telling (which Circumstances are Exceptional)" (2003) 62(3) Cambridge Law Journal 605 at 615-616.
[271] Ronald J Scalise Jr, "Why No "Efficient Breach" in the Civil Law? A Comparative Assessment of the Doctrine of Efficient Breach of Contract" (2007) 55(4) American Journal of Comparative Law 721 at 722.

a theoretical perspective Scots contract law better exemplifies will theory as it offers more robust protection of the performance interest. Yet, in *Cavendish*, Lords Neuberger and Sumption stated that in liquidated damages clauses, a party's interest will "rarely extend beyond compensation."[272] This is entirely inconsistent with will theory, which recognises that a party has an interest in the performance of contractual obligations.

Macgregor has identified a limited exception to the principle that pursuers have a legal right to specific implement.[273] Specific implement will not be awarded for the delivery of goods unless the goods are either (i) unique, or (ii) commercially unique (not readily available). This is significant because the most important factor which the English courts consider when determining whether damages provide an adequate remedy is whether "money can buy a substitute for the promised performance." [274] Therefore, the restriction of the availability of specific implement based on the availability of a substitute is similar to the English approach to specific performance.

(c) Conclusions on specific relief

Despite some inconsistency in the 20th century, it seems that the English courts have returned to the orthodox approach to specific performance: it is not available for breach of contract where damages would provide an adequate remedy. In contrast, in Scotland, a pursuer has a legal right to specific implement, although the pursuer may elect to claim damages, except in the case of contracts for the sale of generic goods.

Furthermore, this theoretical distinction is significant because the English and Scottish cases on the award of specific performance/implement have been decided differently.[275] This is illustrated by the outcomes in *Co-Operative Insurance* and *Retail Parks Investments Ltd* v *The Royal Bank of Scotland Plc (No 2)*.[276] Essentially, both cases concerned whether specific performance/implement could be awarded to enforce continuous trading obligations in commercial leases for units in shopping centres.[277] In the English case of *Co-Operative Insurance*, the House of Lords emphasised the fact that specific performance is a discretionary remedy, and declined to grant specific

[272] *Cavendish* at para 32 per Lords Neuberger and Sumption.
[273] Macgregor (n 227) at 78-79.
[274] Burrows (n 229) 403.
[275] L Macgregor, "Remedies for Breach of Contract in Scots Law", in R Halson and D Campbell (eds), *Research Handbook on Remedies in Private Law* (2019) 336 at 345.
[276] *Co-Operative Insurance*; *Retail Parks Investments Ltd* v *The Royal Bank of Scotland Plc (No 2)* 1996 SC 227, 1996 SLT 669; D Campbell and R Halson, "The Irrelevance of the Performance Interest: A Comparative Analysis of "Keep-Open" Covenants in Scotland and England" in L A DiMatteo, Q Zhou, S Saintier and K Rowley (eds), *Commercial Contract Law: Transatlantic Perspectives* (2013) 466 at 469; Hope (n 227) at 319.
[277] *Co-Operative Insurance* at 9 per Lord Hoffmann; Macgregor (n 275) at 345.

performance.[278] Yet, in the Scottish case of *Retail Parks*, specific implement was awarded.[279] One difference in the facts was that in *Co-Operative Insurance*, the tenant was operating at a loss.[280] Nonetheless, Macgregor has contended that even if there had been submissions that the tenant was trading at a loss in *Retail Parks*, it was unlikely to have affected the outcome.[281] Consequently, Macgregor has argued that these decisions demonstrate that the English and Scottish courts were "poles apart in their attitude to similar facts" and indicate a "real difference between Scots and English law."[282]

The analysis in this section illustrates that while Scots contract law has a mechanism limiting the availability of specific implement for breach of contract, that limitation appears to be the native concept of the equitable jurisdiction of the courts. The next section will go on to explore the question of whether it is possible to see the equitable jurisdiction of the Scottish courts at work across other parts of Scots contract law. This idea will be developed further in chapter VII.

This distinction is highly significant as it raises the question of how the legitimate interest test will operate in Scots law. In *Cavendish*, Lords Neuberger and Sumption stated that the traditional genuine pre-estimate of loss test would continue to be relevant in "simple" cases.[283] In explaining the relevance of specific performance, they found that "the minimum condition for an order of specific performance is that the innocent party should have a legitimate interest extending beyond pecuniary compensation for the breach."[284] This could suggest that the genuine pre-estimate of loss test should be applied first, and only if pecuniary compensation would be insufficient should other interests be considered. This is supported by the fact that one of the conclusions of chapter III was that in some of the English cases following *Cavendish* it appears that the courts took this two-stage approach to the legitimate interest test.[285]

As the discussion has illustrated, the Scottish approach to the availability of remedies is radically different to the English approach, with the limited exception of cases involving the sale of generic goods. In English law, the interest a claimant has in a contract is a secondary right to damages as a substitute for performance.[286] In contrast, in Scots law the pursuer has a legal right to specific implement; i.e., Scots law exemplifies will theory

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[278] *Co-Operative Insurance* at 9, 16 and 19 per Lord Hoffmann.
[279] *Retail Parks* at 243 per Lord McCluskey.
[280] *Co-Operative Insurance* at 9 per Lord Hoffmann.
[281] Macgregor (n 227) at 88.
[282] Macgregor (n 275) at 345; Macgregor (n 227) at 88
[283] *Cavendish* at para 22 per Lords Neuberger and Sumption.
[284] *Cavendish* at para 30 per Lords Neuberger and Sumption.
[285] *De Havilland Aircraft of Canada Ltd* v *Spicejet Ltd* [2021] EWHC 362 (Comm) at paras 33-34 per Sir Michael Burton GBE; *Vivienne Westwood Ltd* v *Conduit Street Development Ltd* [2017] EWHC 350 (Ch), [2017] L & TR 23, at paras 63 and 65 per Timothy Fancourt QC.
[286] *Morris-Garner* v *One Step (Support) Ltd* [2018] UKSC 20 at para 35 per Lord Reed.

and protects the pursuer's interest in performance.[287] Lord President Carloway has recently emphasised the "prominence" of the performance interest in Scots contract law.[288] Hence, from a Scottish perspective, adopting such an approach would mean introducing a hierarchy to the available remedies for breach of contract and importing the particularly English subordination of specific relief to damages only in respect of the penalty doctrine. Taxonomically, this would make the penalty doctrine entirely inconsistent with the rest of Scots contract law.

Furthermore, as highlighted in the previous chapter, accepting that a liquidated damages clause can "extend beyond compensation" for breach would be inconsistent with the compensatory approach taken to damages in Scots law, and could potentially result in windfalls to the pursuers.[289] Consequently, this analysis suggests that the foundation of Lord Neuberger and Sumption's approach to the legitimate interest is incompatible with at least two existing doctrines underpinning Scots contract remedies.

(2) Analysis of *White*

Having considered the applicability of the principles underpinning specific performance to Scots law, this section will now move on to evaluate the "legitimate interest" requirement established in *White*. In *White*, the House of Lords considered whether, notwithstanding an anticipatory breach, the innocent party was entitled to perform their contractual obligations and raise an action for payment.[290] *White* was decided 3:2, however, there was no clear majority with respect to all of the reasoning applied by the judges.[291]

Rowan has questioned whether it is appropriate to look to *White* to understand *Cavendish*, as there is a distinction between an interest in obtaining performance and an interest in giving performance.[292] The *White* series of cases is concerned with whether an innocent party has a legal right to perform their obligations under the contract after the other party has repudiated it. In contrast, *Cavendish* concerns whether an innocent party has a legitimate interest in receiving performance beyond compensation. As a result, Rowan argues that parties have a strong interest in performing, but only a weak interest in receiving performance.[293]

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[287] J Thomson, "Restitutionary and Performance Damages" (2001) 8 SLT 71 at 72.
[288] *Forthwell Ltd* v *Pontegadea UK Ltd* [2024] CSIH 38 at para 56 per Lord President Carloway.
[289] *Cavendish* at para 32 per Lords Neuberger and Sumption.
[290] *White & Carter (Councils) Ltd* v *McGregor* 1962 SC (HL) 1.
[291] Q Liu, "The *White & Carter* Principle: A Restatement" (2011) 74(2) Modern Law Review 171 at 172.
[292] Rowan (n 7) at 158; Liu (n 291) at 187.
[293] Rowan (n 7) at 158.

However, while this conclusion seems compelling on an abstract level, it disregards the fact that under both the *White* and *Cavendish* principles, the onus lies on the party in breach to prove that the innocent party has no legitimate interest in performing or receiving the stipulated payment. Practically, this undermines the argument that a party is treated as having a weak interest in receiving performance in terms of *Cavendish*, especially as the legitimate interest beyond compensation in the penalty context has been defined broadly. Furthermore, one of the fundamental principles of Scots contract law is the mutuality principle: in other words, the idea that a party's right to receive performance and obligation to perform are entwined.[294] Trying to distinguish between these two elements appears overly reductionist given how conceptually intertwined they are.

In *White*, Lord Hodson held, with Lord Tucker agreeing, that the contract "survives [repudiation...] not only where specific implement is available. When the assistance of the Court is not required, the innocent party can choose whether he will accept repudiation and sue for damages for anticipatory breach, or await […] performance."[295] Lord Reid found likewise.[296] Moreover, Lord Reid held that "but it never has been […] the law that a person is only entitled to enforce his contractual rights in a reasonable way, and that a Court will not support an attempt to enforce them in an unreasonable way."[297] Equally, Lord Hodson concluded that there was no equitable doctrine that a party would not be held to his contract unless the Court thought it reasonable.[298]

Yet, Lord Reid added two exceptions to this principle: where the "assent or co-operation" of the breaching party was needed by the innocent party to perform, and where the innocent party had no "legitimate interest" in performance, then the pursuer would not be permitted to raise an action for payment.[299] Lord Hodson made no mention of either of these two exceptions, so there have been questions about whether they form part of the ratio.[300] Nevertheless, there would not have been a majority in White without Lord Reid's opinion.[301] Subsequent cases have also established that Lord

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[294] *Inveresk Plc* v *Tullis Russell Papermakers Ltd* [2010] UKSC 19; 2010 SC (UKSC) 106, at para 31 per Lord Hope; L Richardson, "The Scope and Limits of the Right to Retain Contractual Performance" (2018) (4) Juridical Review 209 at 209.
[295] *White* at 27 per Lord Hodson; 18 per Lord Tucker.
[296] *White* at 12 per Lord Reid.
[297] *White* at 14 per Lord Reid.
[298] *White* at 27 per Lord Hodson.
[299] *White* at 14 per Lord Reid.
[300] *Decro-Wall International SA* v *Practitioners in Marketing Ltd* [1971] 1 WLR 361 at 381 per Sachs LJ; D Campbell, "Reply to Mark P Gergen, 'The Right to Perform after Repudiation and Recover the Contract Price in Anglo-American Law'', in L DiMatteo and M Hogg (eds), *Comparative Contract Law: British and American Perspectives* (2016) 338 at 340.
[301] *Hounslow LBC* v *Twickenham Garden Developments Ltd* [1971] Ch 233 at 254 per Megarry J.

Reid's two exceptions are part of the doctrine on insisting on performance after repudiation.[302]

Specifically, Lord Reid concluded that there is a

> general equitable principle or element of public policy which requires [the] limitation of the contractual rights of the innocent party […] if it can be shown that a person has no legitimate interest, financial or otherwise, in performing the contract rather than claiming damages, he ought not to be allowed to saddle the other party with an additional burden with no benefit to himself.[303]

Interestingly, Lord Reid compared this principle to the one underpinning the penalty doctrine.[304] Significantly, Lord Reid referred to the principle identified in Lord Watson's famous speech in *Grahame*. Discussing the availability of specific implement, Lord Watson held that the court has a discretion as part of its equitable jurisdiction to refuse parties a remedy to which they would ordinarily be entitled.[305]

At this stage, it is also helpful to briefly set out the dissenting opinions, as they are of relevance to one of the subsequent English cases.[306] Both Lord Keith and Lord Morton took into account the duty of the innocent party to mitigate the losses caused by the breach of contract as a reason for finding that the innocent party could not continue to perform.[307] Lord Keith also stated that the pursuers were "precluded from carrying on with their performance by the notice from the defender […] that he does not intend to pay them if they do."[308] Yet, Lord Morton took a slightly different approach, dissenting on the basis that the appellants were "claiming a kind of inverted specific implement of the contract" in a case where specific implement was unavailable as the respondent's only obligation was to pay a sum of money.[309]

In order to understand the meaning of the legitimate interest identified by Lord Reid in the context of anticipatory breach, the next section of this chapter will consider the way in which *White* has been interpreted and applied by the Scottish and English courts.

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[302] Liu (n 291) at 174; *Clea Shipping Corp* v *Bulk Oil International Ltd (The Alaskan Trader) (No 2)* [1983] Lloyd's Law Reports 648 at 651 per Lloyd J.
[303] *White* at 14-15 per Lord Reid.
[304] *White* at 14-15 per Lord Reid.
[305] *White* at 14 per Lord Reid; *Grahame* v *Magistrates of Kirkcaldy* (1882) 9 R (HL) 91 at 91-92 per Lord Watson.
[306] *Attica Sea Carriers Corp* v *Ferrostaal Poseidon Bulk Reederei GMBH (The "Puerto Buitrago")* [1976] 1 Lloyds Rep 250 at 255 per Lord Denning MR.
[307] *White* at 16 per Lord Morton; 21 per Lord Keith.
[308] *White* at 24 per Lord Keith.
[309] *White* at 16 per Lord Morton.

(a) Scottish cases following White

This section will start by looking at the Scottish cases following *White*, before moving on to consider the English cases and assessing whether any differences in approach have arisen in the six decades since *White* was decided in 1962. In *Salaried Staff London Loan Company Ltd* v *Swears and Wells Ltd*, Lord McDonald referred to the speeches of Lords Reid and Hodson, and concluded that there must be a "very cogent reason" and "exceptional circumstances" before the court will refuse to permit a pursuer to enforce a legal right, with "[c]onsideration of what is or is not reasonable" being "quite irrelevant."[310] Lord McDonald also appeared to rely on Lord Reid's dictum as authority, highlighting the legitimate interest exception as a "general equitable principle" limiting the contractual rights of an innocent party[311]

Referring to *Grahame*, Lord McDonald went on to state that "in exceptional circumstances" the court may "refuse a party one of two alternative remedies if enforcing his rights in that way would be inconvenient or unjust or would cause exceptional hardship." As a result, the burden of proof lay on the contract-breaker to prove that there were "special circumstances" which would justify the court withholding the remedy the pursuers were entitled to received.[312] This approach was cited and followed in *Overgate Centre Ltd* v *William Low Supermarkets Ltd*, where Lord Cameron found no such "exceptional circumstances" to justify refusing the remedy.[313]

In *AMA (New Town) Ltd* v *Law*, the Inner House considered an action for payment of the purchase price under contracts for the sale of heritable property.[314] Lady Dorrian held that implement would only be refused under the court's equitable jurisdiction in "highly unusual" or "'wholly exceptional'" circumstances where an award would "impose a burden on the repudiating party completely out of proportion to the remainder of the contract; where the circumstances fell short of frustration but where implement of the contract would be so unreasonable as to be manifestly unjust."[315] Lady Dorrian provided the example of a contract for sale, and stated that implement of the contract would not be refused just because it would "inconvenience" the seller, but that if the price demanded were "exorbitant" the court would consider refusing implement to the purchaser.[316]

In contrast, in *AMA (New Town) Ltd* v *McKenna*, Sheriff Principal Bowen claimed that Lord Reid's dictum in White & Carter supported the conclusion that an innocent party's

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[310] *Salaried Staff London Loan Company Ltd* v *Swears and Wells Ltd* 1985 SC 189, 194 (Lord McDonald).
[311] *Salaried Staff* at 194 per Lord McDonald.
[312] *Salaried Staff* at 199 per Lord McDonald.
[313] *Overgate Centre Ltd* v *William Low Supermarkets Ltd* 1995 SLT 1181 at 1186 per Lord Cameron.
[314] *AMA (New Town) Ltd* v *Law* [2013] CSIH 61, 2013 SC 608 at para 7 per Lady Dorrian.
[315] *Law* at para 56 per Lady Dorrian.
[316] *Law* at para 57 per Lady Dorrian.

ability to enforce their right to disregard repudiation and insist on implement was "restricted."[317] Subsequently, in the authoritative Inner House decision of *Law*, Lady Dorrian criticised this aspect of the decision in *McKenna*.[318] Lady Dorrian concluded that the presumption had been inversed, and that "the innocent party will be able to [enforce a repudiated contract] unless circumstances render it impossible, or in exceptional circumstances, wholly unjust."[319]

Similarly, in *Scottish Metropolitan Property plc* v *Christie,* Sheriff Macphail construed the legitimate interest requirement as invoking the principle in *Grahame* that the court can refuse to enforce a legal right on equitable grounds.[320] Yet, Sheriff Macphail stated that when determining whether the pursuers have a substantial interest in enforcing an obligation rather than claiming damages it would be "necessary to consider the nature and extent of the loss they would be likely to sustain by accepting the company's repudiation […] and to determine whether that loss would be recoverable as damages."[321] This analysis is inconsistent with the Scottish approach to the relationship between specific implement and damages: as set out in the previous section, the pursuer has a legal right to specific implement.

Overall, as Lord Reid's citation of Lord Watson's dictum relating to specific implement and the Scottish cases post-*White* indicate, there is a close relationship between the reasons why a court may refuse to award specific implement, and the legitimate interest requirement for electing to perform after repudiation. The majority of cases following *White* have continued to highlight the latitude innocent parties will be given by the courts when determining whether they had a legitimate interest in keeping the contract alive and continuing to perform.

Significantly, *White* and the subsequent Scottish cases have adopted Lord Watson's conclusion that the court's equitable jurisdiction constrains awards of specific implement in the context of insisting on performance. Specific implement and insisting on performance after repudiation operate similarly, and could be seen as two sides of the same coin. If there is breach of contract, the innocent party has a legal right to specific implement and to compel the debtor to performing their contractual obligations. The innocent party also has right to perform their own obligations although the debtor wishes to repudiate the contract. As with specific implement, the starting point with insisting on performance is that the courts will enforce the innocent party's right, and the onus will lie on the defender to persuade the court otherwise. It is only in exceptional cases, going beyond inconvenience or the innocent party acting unreasonably, where an award

[317] *AMA (New Town) Ltd* v *McKenna* 2011 SLT (Sh Ct) 73 at para 18 per Sheriff Principal E F Bowen QC.
[318] *Law* at para 48 per Lady Dorrian.
[319] *Law* at para 48 per Lady Dorrian.
[320] *Scottish Metropolitan Property plc* v *Christie* 1987 SLT (Sh Ct) 18 at 25 per Sheriff I D Macphail.
[321] *Christie* at 26 per Sheriff I D Macphail.

would be manifestly unjust and out of proportion, that the court will refuse to permit the innocent party to perform their contractual obligations following repudiation. Hence, it could be argued that the court's equitable jurisdiction is a general concept restricting the availability of specific implement and the innocent party's right to insist on performing their contractual obligations.

Notably, Lady Dorrian's language in *Law* when setting out the reasons why a court may refuse to grant an action for payment bears a striking resemblance to the language used in *Cavendish*. The similarity lies in the comments made concerning when a stipulation will be held to be an unenforceable penalty: considering the "exorbitance" of the price, the proportionality of the burden, and whether it would be so "unreasonable as to be manifestly unjust." Therefore, the interpretation of the legitimate interest test established in *White* by the Scottish courts supports the conclusion that there are common elements between the concept of legitimate interest in the penalty doctrine and the right to perform after repudiation.

(b) English cases following White

Having described the interpretation of the legitimate interest requirement set out in *White* by the Scottish courts, this section outlines the way in which the approach of the English courts has diverged from the Scottish approach.

A particularly important case in the development in the English courts was *The Puerto Buitrago*, where the question of performance after repudiation was answered (obiter) by two of the three judges.[322] Significantly, Lord Denning criticised the decision in *White & Carter*, stating that unless a case arose which was "precisely on all fours" with *White*, he would not follow it.[323] Instead, he concluded that, in suing for the price, the plaintiff was seeking to enforce specific performance, and "should not be allowed to do so when damages would be an adequate remedy."[324] Lord Denning's reasoning bears a clear resemblance to Lord Morton's dissent in *White & Carter*.[325] Lord Denning's formulation greatly restricts the protection of the performance interest by effectively introducing the requirement that specific performance must be available before a party can refuse repudiation. Consequently, Lord Denning's formulation appears entirely inconsistent with the Scottish approach, which does not classify specific relief as a secondary remedy, unavailable if damages are an adequate remedy.

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[322] *Attica Sea Carriers Corp* v *Ferrostaal Poseidon Bulk Reederei GMBH (The "Puerto Buitrago")* [1976] 1 Lloyds Rep 250 at 254 per Lord Denning MR; 255 per Orr LJ; 256 per Browne LJ.
[323] *The Puerto Buitrago* at 255 per Lord Denning MR.
[324] *The Puerto Buitrago* at 255 per Lord Denning MR.
[325] *The Puerto Buitrago* at 255 per Lord Denning MR.

In contrast, Lord Justice Orr (with Lord Justice Browne concurring) applied Lord Reid's two exceptions, and he found against the owners on the basis of Lord Reid's co-operation exception.[326] Nevertheless, as the subsequent cases illustrate, Lord Denning's opinion that performance should not be permitted where damages would be an adequate remedy came to be an accepted requirement when applying the legitimate interest test.

The next development in the English courts arose in *The Odenfeld*.[327] In *The Odenfeld*, Kerr J acknowledged that he was bound by the decision of the Court of Appeal in the *Puerto Buitrago*, and as a result there was a "fetter on the innocent party's right of election" which would "only be applied in extreme cases, viz where damages would be an adequate remedy and where an election to keep the contract alive would be wholly unreasonable."[328] Essentially, Kerr J introduced a reasonableness requirement, which narrowed the scope of the legitimate interest exception to the principle that an innocent party has a right to perform following repudiation.

Essentially, this two-pronged approach to the legitimate interest requirement came to be accepted by the English courts: performance would be refused in a "very limited category of cases" where damages would be an adequate remedy, and electing to keep the contract alive would be "wholly unreasonable."[329] In *The Aquafaith,* Cooke J described the proportionality aspect as a requirement that the innocent party's election was ""wholly unreasonable", "extremely unreasonable" or, perhaps, […] "perverse"."[330]

In *The Dynamic,* Simon J held that onus lies on the party in breach to prove that the innocent party has no legitimate interest in performing rather than claiming damages, and that the "burden is not discharged merely by showing that the benefit to the other party is small in comparison to the loss to the contract breaker."[331]

Finally, in *MSC Mediterranean Shipping Company SA* v *Cottonex Anstalt* Lord Justice Moore-Bick LJ (Tomlinson LJ and Keehan J concurring), essentially applied the test as formulated by Cooke J in *The Aquafaith*, finding that it would have been "wholly unreasonable […] to insist on further performance."[332] Interestingly, one of the factors taken into account in reaching this decision was the fact that replacement containers

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[326] *The Puerto Buitrago* at 256 per Orr LJ; 256 per Browne LJ.
[327] *Gator Shipping Corp* v *Trans-Asiatic Oil Ltd SA and Occidental Shipping Establishment (The "Odenfeld")* [1978] 2 Lloyds Rep 357.
[328] *The Odenfeld* at 373-374 per Kerr J.
[329] *Reichman* v *Beveridge* [2006] EWCA Civ 1659 at para 17 per Lloyd LJ; *Isabella Shipowner SA* v *Shagang Shipping Co Ltd (The "Aquafaith")* [2012] EWHC 1077 (Comm) at para 44 per Cooke J.
[330] *The Aquafaith* at para 44 per Cooke J.
[331] *Ocean Marine Navigation Ltd* v *Koch Carbon Inc (The "Dynamic")* [2003] EWHC 1936 Com at para 23 per Simon J.
[332] *MSC Mediterranean Shipping Company SA* v *Cottonex Anstalt* [2016] EWCA Civ 789 at para 43 per Moore-Bick LJ); para 52 per Tomlinson LJ); para 65 per Keehan J.

were readily available.[333] This stands out as the most important factor taken into account by the English courts when considering whether damages are an adequate remedy, namely whether appropriate substitutes were readily available.[334]

In conclusion, there are commonalities between the Scottish and English interpretations of the legitimate interest test established by *White & Carter*. In both jurisdictions, the general rule is that the innocent party has a right to elect between accepting the repudiation and claiming damages, or refusing it and performing where the co-operation of the party in breach is not required. Under both approaches, in exceptional cases, the court can exercise its equitable jurisdiction. In the exercise of this jurisdiction, an innocent party can be refused the remedy to which it would ordinarily be entitled, where they have no legitimate interest in performing.

Furthermore, under both English and Scots law the onus lies on the party in breach to prove that the innocent party has no legitimate interest in performance. Lastly, under both formulations of the legitimate interest test, the courts will assess the proportionality of permitting performance, and a high bar must be reached before the courts will find that performance is sufficiently disproportionate or unreasonable.[335] As Rowan describes it, "[p]erformance is the rule and a finding that the injured party has no interest in performing will be rare."[336] These similarities could suggest that Scots contract law has a common concept of legitimate interest as described in *Cavendish*.

However, in contrast to the results in the Scottish cases, the English courts have made reference to whether damages would be an adequate remedy, following Lord Denning's dictum in *The Puerto Buitrago*. It is unclear what the practical effect of this difference is given the additional requirement that the innocent party act wholly unreasonably.

(3) Conclusion

Given that Lord Reid's opinion in *White & Carter* was so entwined with Lord Watson's judgments on specific implement, it is perhaps unsurprising to see the distinction detailed in the second part of this chapter. In contrast to the Scottish courts, the English courts have considered whether damages would be an adequate remedy when determining whether an innocent party has a legitimate interest in performing after repudiation. In Macgregor's discussion of specific implement, she highlighted *White & Carter* as exemplifying the "traditionally high value placed by the Scottish courts on performance rather than damages."[337] Thus we can see that the divergence between

[333] *Cottonex* at para 43 per Moore-Bick LJ).
[334] Burrows (n 229) 403.
[335] Rowan (n 7) at 156.
[336] Rowan (n 7) at 156.
[337] Macgregor (n 227) at 89.

the Scottish and English approaches may be a reflection of the underlying differences relating to the approach to damages.

Another element shared by the *White* and *Cavendish* legitimate interest tests is the proportionality test. Under both approaches, there is a high bar that must be overcome before the courts will determine that performance/the stipulation for payment is sufficiently unreasonable that they should withhold from the innocent party what they would ordinarily be entitled to receive. This suggests that there are some shared characteristics between the legitimate interest in *Cavendish* and in Scots contract law.

On the other hand, the comparison between specific performance and specific implement suggests that the legitimate interest described in *Cavendish* is distinct from the concept of legitimate interest native to Scots law. In English law, the requirement that specific performance will only be available where damages would not provide an adequate remedy is almost diametrically opposed to the attitudes of the Scottish courts regarding the availability of specific implement. *Cavendish* seems more aligned with the English approach in this regard. Not only did Lords Neuberger and Sumption highlight specific performance as relevant in their judgments, but they stated that the traditional genuine pre-estimate of loss test would continue to be relevant in "simple" cases.

This indicates that it is only in more difficult cases that the courts would need to consider whether parties have an interest in performance itself that goes beyond financial compensation; i.e., recovery under a penalty clause can only exceed what would be recoverable as damages where damages are deemed inadequate. This is inconsistent with the fact that, in Scots law, parties have a legal right to specific implement and performance even where damages would be an adequate remedy. As Thomson describes, in Scots law there is "only one obligation in a contract, viz the duty to perform."[338]

Following *Cavendish*, the defender might argue that the pursuer does not have an interest beyond compensation, and therefore that the penalty clause should not be enforced. The problem is that in Scots law, parties have a legal right to performance even where damages would be an adequate remedy. Parties in Scots law always have an interest beyond compensation, so the minimum requirement that the pursuer should have an interest beyond pecuniary compensation is always fulfilled. Consequently, the incongruence between the protection of the legitimate interest in *Cavendish* and the way in which specific implement operates suggests that there is no commonality between specific implement and the concept of legitimate interest (in the *Cavendish* sense), although there are some shared characteristics between the *Cavendish* legitimate interest test and the Scottish cases following *White*.

[338] Thomson (n 287) at 72.

Instead of a general legitimate interest principle, this dissertation argues that there is a native Scottish approach to limiting the availability of remedies for breach of contract: through the court's equitable jurisdiction. This is illustrated by the fact that *White* and the subsequent Scottish cases have approved of Lord Watson's speeches on the availability of specific implement being constrained in the exercise of the court's equitable jurisdiction. In both cases, a party's right to a remedy is limited in exceptional cases where an award would be manifestly unjust to the defender and out of all proportion to the gain to the pursuer, and the onus lies on the defender to put forward cogent reasons to persuade the court to refuse the exercise of a party's normal legal rights. The concept of the court's equitable jurisdiction will be expanded upon in chapters VI and VII.

F. CHAPTER VI - THE INTERRELATIONSHIP BETWEEN THE COURT'S EQUITABLE JURISDICTION AND THE PENALTY DOCTRINE

As stated in chapter IV, in *Cavendish*, the Supreme Court was at pains to emphasise the similarity between Scots and English law.[339] Nonetheless, Lord Hodge also identified one key difference: in Scots law, the court has a power as part of its equitable jurisdiction to modify a penalty.[340] The power of modification enables the court to restrict recovery to the pursuer's actual losses where a stipulation is found to be a penalty.[341]

In contrast, the Supreme Court held that there was no equivalent power to modify penalty clauses under English law, overturning a Court of Appeal case.[342] Under English law, if a clause is deemed to be a penalty, it is simply unenforceable, and cannot be enforceable on terms modified by the court.[343]

This raises the question of what effects *Cavendish* will have on the power of modification. In order to answer this question, this chapter begins by examining the origins of the power of modification and considering the court's equitable jurisdiction. This will lay the foundation for an analysis of how the power of modification might be developed in response to *Cavendish*.

(1) Origins of the power of modification

[339] *Cavendish* at para 216 per Lord Hodge.
[340] *Cavendish* at para 252 per Lord Hodge.
[341] *Wright* v *M'Gregor* (1826) 4 S. 434, 436 (Lord Alloway).
[342] *Cavendish* at paras 85-87 per Lords Neuberger and Sumption; para 283 per Lord Hodge; *Jobson* v *Johnston* [1989] 1 WLR 1026.
[343] *Cavendish* at para 89 per Lords Neuberger and Sumption.

As stated in chapter II, the origins of the penalty doctrine in Scots law can be found in negative attitudes taken against usury in the 16th century.[344] According to Bell, the principles underpinning the power of modification are the same as those supporting laws against usury.[345] Bell stated that the Court of Session had a power to mitigate penalties "as the supreme court of law and equity."[346] Equity developed as an idea in Scots law based on the influence of Roman law during the 17th and early 18th centuries, and it is an important an important source of Scots law.[347] Due to the scope of this dissertation, it is not possible to explore the evolution of equity as a concept in Scots law in detail.[348]

It is helpful to outline the function of equity in Scots law. Three key themes have been identified: "the individualisation of adjudication, the appeal to a higher justice, and the dispensing power."[349] Another important concept relating to our understanding of equity is the view that equity is the "fundamental normative essence" which underpins the law.[350] This has been expressed as Scots law being "suffused with equity" and reflects the unitary system of law and equity in Scotland.[351]

The idea behind the 'dispensing power' is that equity has a role in 'correcting' the position under strict law, and is intertwined with judicial discretion.[352] Historically, the Court of Session has had an "officium nobile", going above the "officium ordinarium" of the inferior courts.[353] Traditionally, the officium ordinarium simply referred to the application of rules which (i) included equity as a standard of adjudication, or (ii) were of equitable origin.[354] The nobile officium jurisdiction was an extraordinary equitable jurisdiction exercised when the Court of Session needed to "Correct the Extremities" of strict law.[355] As an example, Stair identified the power to "modify exorbitant penalties […] even tho' they bear the name of liquidate expences with confent of parties."[356]

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[344] McBryde, *Contract* para 22-158; *Home* v *Hepburn* (1549) Mor 10033; S J Bogle, "Spiritual Duties and Legal Debts in Seventeenth Century Scotland: A Preliminary Study" (SSRN 5164494 2025) at 8-9.
[345] Bell, *Com* III, 656.
[346] Bell, *Com* III, 656.
[347] W M Gordon, "Roman Law as a Source", in D M Walker (ed), *Stair Tercentenary Studies* (1981) 107 at 108-109; D M Walker, "Stair's Contribution to Scots Law", in D M Walker (ed) *Stair Tercentenary Studies* (1981) 250 at 250-251; Daniel J Carr, *Ideas of Equity* (2017) para 2-04.
[348] D Walker, "Equity in Scots Law" (1954) 66(2) Juridical Review 103; Carr (n 364) paras 2-08-2-81.
[349] R B Ferguson "Equity", in *The Laws of Scotland: Stair Memorial Encyclopaedia* vol 22 (1990) at para 394.
[350] Carr (n 364) at para 2-51.
[351] N R Whitty, "From Rules to Discretion: Changes in the Fabric of Scots Private Law" (2003) 7(3) Edinburgh Law Review 276 at 289.
[352] Carr (n 364) at para 2-51.
[353] Stair, *Inst*, 4.3.1.
[354] Ferguson (n 349) at para 430.
[355] Stair, *Inst*, 4.3.1.
[356] Stair, *Inst*, 4.3.2.

(2) Questions arising post-*Cavendish*

This section will begin by outlining one of the main ways in which *Cavendish* might affect the power of modification. This dissertation focuses on the way in which the introduction of the legitimate interest test will affect the power of modification. The SLC has also considered the effect of *Cavendish* on penalties supporting performance obligations (as distinct from obligations to pay money).[357] Unfortunately, due to the scope of this dissertation, it is not possible to provide more details on this point.

This section considers the way in which the introduction of the legitimate interest test impacts the power of modification. As stated previously, the traditional role of the power of modification is to limit recovery to the pursuer's actual loss where a clause is found to be a penalty. Consequently, it seems natural to suggest that, in the simple cases where the pursuer's legitimate interest is found to be restricted to compensation, the power of modification could continue to be exercised in the same way as it was prior to *Cavendish*.

However, the possibility of a legitimate interest extending beyond compensation necessarily raises questions about how the power of modification could operate. If the power of modification continued to be exercised in the same way even where the interest in performance went beyond compensation, the result would be a much greater interference with the contract, restricting recovery to a greater extent. Thus, the power of modification would appear to be doctrinally inconsistent with the legitimate interest test in its current construction, as modification would shift the basis of the remedy from protecting a performance interest to only providing compensation.

A possible solution could be to use the court's equitable jurisdiction to develop the power of modification to harmonise it with the new legitimate interest test. As highlighted in this chapter, this would accord with the traditional purposes of equity in developing the law: providing greater flexibility and enabling the court to 'correct' the strict law with its dispensing power.

If it is accepted that the court should utilise its equitable jurisdiction in such a way, the question then becomes, in which way should the power of modification be reformed in order to account for the new legitimate interest test? This problem harkens back to the problem identified with the legitimate interest test itself in chapter III: it is only defined by negation. If the only requirement of the legitimate interest test is that the stipulation is not punitive, it is unclear what the appropriate measure for the stipulation should be.

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[357] Discussion Paper on *Penalty Clauses* (Scot Law Com No 162, 2016) paras 3.33 and 5.65-5.66; Report on *Penalty Clauses* (Scot Law Com No 171, 1999) para 6.16.

Hence, there would be uncertainty over to what the power of modification should be used to reduce the penalty to.

As set out in chapter III, one way in which the courts have dealt with the lack of an objective comparator like the actual loss suffered by the parties has been to scrutinise the relevant market rates. Therefore, a suggested solution to keep the modification power effectual could be to reduce stipulations held to be penalties to the market rate as an appropriate measure of the relevant performance interest. The problem with this solution would be that it would only operate where the court has a market rate to turn to – depending on the facts, there may not be a convenient market rate for the court to rely upon. Nevertheless, the view might be taken that developing the modification power in this way would still provide a better solution than constraining it to actual loss even where the parties' legitimate interest has been found to extend beyond compensation.

Another alternative where there is no independent market rate could be to suggest that the court simply exercise its discretion to determine the appropriate award. This would have the advantage of flexibility, a traditional value of equitable solutions. Yet, such a development would be ill-advised, as it would drastically increase the uncertainty involved, and would have the effect of essentially re-writing the parties' contract – something which the courts have traditionally avoided.[358]

Finally, the power of modification has been placed on statutory footing where the penalty supports an obligation to pay a sum of money.[359] Section 5 of the Debts Securities (Scotland) Act 1856 provides in such cases, "it shall be in the power of the court to modify and restrict such penalties, so as not to exceed the real and necessary expenses incurred in making the debt effectual." This is a problem since equity's status as a source of law does not include the power to overrule statute, so any reform in this area must take into account the fact the legislation is still based on the genuine pre-estimate of loss test and does not reflect the new legitimate interest test.[360]

(3) Conclusion

The power of modification is a clear example of the dispensing power of the court's equitable jurisdiction, correcting the law where parties would otherwise be required to pay exorbitant penalties. The orthodox approach to the modification power restricts recovery to the actual loss suffered. As such, the traditional approach is inconsistent with the new legitimate interest test introduced by *Cavendish*.

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[358] *Cavendish Square Holding BV* v *Makdessi*; *ParkingEye Ltd* v *Beavis (Consumers' Association Intervening)* [2015] UKSC 67, [2016] AC 1172 at para 87 per Lords Neuberger and Sumption.
[359] S5 Debts Securities (Scotland) Act 1856.
[360] *Adair* v *David Colville & Sons Ltd* 1922 SC 672 at 677 per Lord Justice-Clerk Dickson.

It could be argued that the court's equitable jurisdiction could provide an appropriate avenue to address these problems, considering equity's traditional role in advancing the law.[361] This would have the benefit of improving the doctrinal alignment between the new legitimate interest test and the modification power, as well as providing the courts with greater flexibility when exercising the modification power to reach a just result. Yet, the authority of the court's equitable jurisdiction ends at the boundary with legislation, and thus legislative reform would be necessary to update the 1856 Act.

G. CHAPTER VII - A WAY FORWARD FOR THE PENALTY DOCTRINE IN SCOTS LAW

Having set out the historic Scots law approach to the penalty doctrine and highlighted the repercussions of the new *Cavendish* test, this chapter aims to identify outstanding problems which must be resolved going forward. Before doing so, the first question which must be answered is what effect *Cavendish* will have in Scots contract law, and whether it is even authoritative.

Subsequently, this chapter develops upon the rationale for the penalty doctrine. In chapter II, two main rationales for the Scottish approach to the penalty doctrine were identified: (1) enabling parties to avoid litigation, and (2) protecting parties from exorbitant penalties. Chapter III highlighted how the principles of freedom of contract and certainty for contracting parties influenced the Supreme Court's reformulation of the penalty doctrine in Cavendish.[362] Although Halson set out a more detailed framework of rationales for the penalty doctrine, chapter VII takes the traditional Scottish rationales as its starting point.[363]

Given the dual Scottish justifications for the penalty doctrine, this chapter begins by criticising the failure of the legitimate interest test to provide contracting parties with greater certainty, especially given that this concern appears to have been at the forefront of the judges' minds in *Cavendish*. To address this problem, it will be suggested that the Scottish approach to the penalty doctrine should be reformed, so that liquidated damages clauses act as a cap on claims for damages. This would have the effect of reducing litigation and would therefore improve certainty for the contracting parties.

The second half of the chapter is concerned with the protections afforded by the penalty doctrine. There is an inherent tension between the two rationales for the penalty doctrine. If the courts are given greater discretion to interfere with penalty clauses to

[361] Carr (n 364) para 2-81.
[362] *Cavendish* at paras 33 and 43 per Lords Neuberger and Sumption; paras 248-259 per Lord Hodge.
[363] Halson (n 143) paras 4.03-4.67.

protect parties, the contracting parties have less certainty that clauses will be upheld. Conversely, if the ambit of the penalty doctrine is reduced, then parties will have more certainty that the clause is enforceable. Yet, it follows from reducing the scope of the penalty doctrine that the courts have less ability to protect parties from excessive sanctions. Therefore, *Cavendish* represents a rebalancing of these concerns, narrowing the scope of the penalty doctrine and decreasing the protection from abuse. This chapter considers the potential for reform in two dimensions: (a) focusing specifically on consumers, and (b) exploring the potential of broader reform of the court's equitable jurisdiction. Problems relating to the power of modification and potential reforms of that power will not be discussed in this chapter, as they were addressed in Chapter VI.

(1) Is *Cavendish* authoritative?

The first question that must be considered is whether *Cavendish* is authoritative in Scots law. Although the Supreme Court is the final court of appeal for civil appeals for both English and Scottish cases, Scots and English law remain distinct jurisdictions.[364] In Scots law, there is significant concern over the uncritical adoption of principles from English law.[365] An infamous example of this is the introduction of the floating charge into Scots property law, which has caused doctrinal problems with Scots property law and generated substantial academic critique.[366]

Nevertheless, where English and Scots law are identical, English decisions of the Supreme Court will be binding on the Scottish courts.[367] The problem with *Cavendish* is that the Scots law approach to the penalty doctrine, while overlapping with the English approach, was not identical. This dissertation has identified two major differences: the power of modification enjoyed by the Scottish courts, and the development of the English 'commercial justification' cases.

However, even if not strictly authoritative in Scots law, *Cavendish* is highly persuasive.[368] It seems clear from the Supreme Court's comments about the similarity of Scots law on the penalty doctrine that the decision in *Cavendish* was intended to be

[364] S40(2) and s41(1) Constitutional Reform Act 2005; s117 Courts Reform (Scotland) Act 2014.
[365] J Hardman, "Some Legal Determinants of External Finance in Scotland: A Response to Lord Hodge" (2017) 21(1) Edinburgh Law Review 30 at 31; TB Smith, "English Influences on the Law of Scotland" (1954) 3(4) The American Journal of Comparative Law 522 at 523.
[366] D Cabrelli, "The Case Against the Floating Charge in Scotland" (2005) 9(3) Edinburgh Law Review 407 at 421; J Hardman and A DJ MacPherson (eds), *Floating Charges in Scotland: New Perspectives and Current Issues* (2022).
[367] M H Dewart, *The Scottish Legal System*, 6th edn (2019) para 12.21; *Glasgow Corporation* v *Central Land Board* 1956 SC (HL) 1 at 16-17 per Lord Normand; *Dalgleish* v *Glasgow Corporation* 1976 SC 32 at 52 per Lord Justice-Clerk Wheatley.
[368] Discussion Paper on *Penalty Clauses* (Scot Law Com No 162, 2016) para 1.7.

applicable to Scots law in addition.[369] Multiple Scottish decisions have also referred to *Cavendish* with approval, albeit obiter.[370] In addition, *Cavendish* has been applied at Sheriff Court level.[371] Consequently, it seems clear that *Cavendish* will be applied in Scots law, and this chapter will not consider the possibility of Scots contract law rejecting *Cavendish* as the Singapore Court of Appeal recently did.[372]

(2) Certainty and preventing litigation

(a) Certainty and the legitimate interest

A major problem with the new legitimate interest test is the uncertainty regarding what constitutes a legitimate interest, and therefore, when the court will refuse to enforce a stipulated sanction. As stated in Chapter III, *Cavendish* did not provide a positive definition of a legitimate interest but rather stated that punishment was not a legitimate interest.[373] Chapter III identified some relevant factors to be considered in determining whether an interest is legitimate but also criticised some of these factors. For example, one consideration would be the comparable market rate but practically, there may not be a comparable market rate. This lack of clarity has attracted significant academic criticism.[374] This problem is particularly pertinent given the rationale of certainty behind the penalty doctrine, and the Supreme Court's justifications for the new formulation. As stated in Chapter II, one facet of the justification for liquidated damages clauses in Scots law is that it helps parties avoid the time and expense associated with litigation.[375] This was explicitly recognised in *Cavendish* by Lord Hodge.[376]

On the other hand, Halson has argued that the value of penalty clauses in saving transaction costs has been overstated.[377] Halson contends that the efficiency argument is predicated on the assumption that all stipulations will be enforced, and fails to take into account the resources parties dedicate to avoid stipulations being treated as penalties, including assessing likely prospective damages, and negotiating and drafting

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[369] *Cavendish Square Holding BV* v *Makdessi*; *ParkingEye Ltd* v *Beavis (Consumers' Association Intervening)* [2015] UKSC 67, [2016] AC 1172 at para 216 per Lord Hodge.
[370] *Gray* v *Braid Group (Holdings) Ltd* [2016] CSIH 68 at paras 106-108 per Lord Menzies; *Indigo Park Services UK Ltd* v *Watson* 2017 GWD 40-610 at para 46 per Sheriff Drummond.
[371] *ZLX Ltd* v *James Mackie Wholesale Ltd* [2024] SC GLA 38 at para 52 per Sheriff S Reid.
[372] *Denka Advantech Pte* v *Seraya Energy Pte* [2020] SGCA 119; R Halson, "Liquidated Damages and Penalties – A Review of the Cavendish decision by the Singapore Court of Appeal" (2021) 137(Jul) Law Quarterly Review 375 at 376.
[373] *Cavendish* at paras 13, 28, 30-31 per Lords Neuberger and Sumption; paras 148, 152 and 198 per Lord Mance; paras 243 and 248 per Lord Hodge.
[374] Summers (n 127) at 95; Rowan (n 7) at 148.
[375] *Henderson v Maxwell* (1802) Mor 10054 at 10055.
[376] *Cavendish* at para 259 per Lord Hodge.
[377] Halson (n 143) para 4.17.

the stipulation.[378] Furthermore, the efficiency argument fails to explain why liquidated damages clauses are not always enforced.[379]

Nevertheless, part of the rationale for the reformulation of the penalty doctrine was to improve certainty for contracting parties by narrowing the scope of the penalty doctrine. For example, Lords Neuberger and Sumption stated that the penalty doctrine "undermine[d] the certainty which parties are entitled to expect of the law."[380] The Supreme Court also referred to Lord Woolf's dictum in *Philips Hong Kong*, where he "emphasised the interest that parties have in being able to know with a reasonable degree of certainty the extent of their liability and the risks they run."[381]

Moreover, the quantitative data does not support the argument that *Cavendish* has greatly reduced litigation over the penalty doctrine. While there has only been one Scottish case directly concerned with the penalty doctrine since *Cavendish*, in the two decades prior to *Cavendish*, there were only three such decisions.[382] Yet, it would be premature to come to a definitive conclusion on this point; it has only been approximately a decade since *Cavendish* was decided, so the data is very limited.

Finally, we must also consider that liquidated damages clauses are essentially a self-help remedy, intended to operate without the need for judicial intervention. Ideally, therefore, the penalty doctrine should be simple enough for parties to create enforceable liquidated damages clauses without advice. As the Supreme Court in Cavendish acknowledged, there may be a wide disparity between the types of parties using liquidated damages clauses, and the Supreme Court highlighted the difference between parties with access to legal advice, and those without.[383] Contracting parties will only discover that a liquidated damages clause is an unenforceable penalty after breach, at the point where they receive a decision from a court and they cannot take action to remedy it. As such, ideally the legitimate interest test should be sufficiently clear to allow parties to understand without recourse to lawyers, especially as the cost of legal advice cuts into the savings in transaction costs.

One possibility discussed by the SLC to was to set out a non-exhaustive list of potential legitimate interests: "(a) actual performance of the creditors' obligations by the debtor, (b) encouragement of prompt or early performance by the debtor, (c) avoidance of

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[378] Halson (n 143) para 4.17-4.18.
[379] E A Posner, "Economic Analysis of Contract Law after Three Decades: Success or Failure" (2003) 112(4) Yale Law Journal 829 at 880.
[380] *Cavendish* at para 33 per Lords Neuberger and Sumption.
[381] *Cavendish* at para 144 per Lord Mance; *Philips Hong Kong Ltd* v *Attorney General of Hong Kong* [1993] 61 BLR 41, Const LJ 1993, 9(3) at 202-213, 207 per Lord Woolf.
[382] *ZLX Ltd*; *Yizhen Li* v *First Marine Solutions Ltd* UKEATS/0045/13/BI; *Agri Energy* v *McCallion* [2014] CSOH 13; *Hill* v *Stewart Milne Group* [2011] CSIH 50; *Wirral BC* v *Currys Group Plc* 1998 SLT 463.
[383] *Cavendish* at para 35 per Lord Neuberger and Sumption; para 152 per Lord Mance; para 274 per Lord Hodge.

litigation, and (d) other commercial interests of the creditor."[384] Other possible legitimate interests highlighted by the SLC were "(a) the protection of third parties who [would] suffer loss […] but who [were] not party to the contract and […] (b) the promotion of wider societal goals."[385] Ultimately, the SLC decided against recommending specific legislative reform relating to the penalty doctrine.[386]

While potentially useful in identifying the relevant interests in a particular case, the SLC's suggestion is not a perfect solution. It does not aid understanding of legitimate interest , simply detailing interests which have been accepted in cases. The category of "other commercial interests" is also vague. Finally, it leaves open the possibility of other interests potentially being held legitimate, which suggests that it would not improve certainty of the legitimate interest test.

Overall, one of the core justifications for the introduction of the legitimate interest test in *Cavendish* was to improve certainty for contracting parties. By decreasing the ambit of the penalty doctrine, the new test aimed to reduce court interference with stipulations, and thereby decrease the transaction costs associated with litigation. Aligned with this is the fact that the enforcement of stipulations is partially predicated on saving parties the expense and time associated with judicial remedies. The current doubt over the meaning of legitimate interest frustrates this aim and invites further development by the courts.

(b) The relationship between the penalty doctrine and damages

This section addresses two related questions about the relationship between the penalty doctrine and damages arising out of *Cavendish*. Firstly, should damages be capped by a liquidated damages clause which is not held to be a penalty?[387] Secondly, should damages be restricted to the amount stipulated for if the sum is held to be a penalty? These questions are relevant in the situation where the creditor's recoverable loss through damages is greater than the sum provided for by the liquidated damages clause, in which case, it may be the pursuer who wishes to argue that the provision is a penalty.[388] *Cavendish* itself provided no guidance on this point.[389]

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[384] Discussion Paper on *Penalty Clauses* (Scot Law Com No 162, 2016) para 5.53.
[385] Discussion Paper on *Penalty Clauses* (Scot Law Com No 162, 2016) para 5.53.
[386] Report on *Review of Contract Law: Formation, Interpretation, Remedies for Breach, and Penalty Clauses* (Scot Law Com No 252, 2018) para 2.24.
[387] E Andrews, "The Penalty Doctrine, Relief against Forfeiture, and Unconscionability in Anglo-Canadian Law" 86(2) Saskatchewan Law Review 197 at 204.
[388] Burrows (n 229) 394.
[389] Andrews (n 387) 204.

As set out in Chapter II, the historic Scots law authority on this question is mixed. Originally, damages were restricted to the penalty stipulated for, on the basis that otherwise pursuers would obtain an advantage under the penalty doctrine.[390] Subsequently, it was held that damages would not be restricted by the penalty, since limiting compensation would enable the defender to "escape all the consequences of his breach."[391]

The question of whether the penalty acts as a cap to damages is more pertinent after *Cavendish*, given that the basis for recovery under the traditional genuine pre-estimate of loss test was compensation, the same as for damages.[392] Yet, following *Cavendish*, parties are permitted to provide for recovery going beyond compensation.[393] Does it remain appropriate to permit parties to claim damages where their own estimates of their legitimate interests fall short of their actual losses? Furthermore, if the accepted rationale for narrowing the penalty doctrine in *Cavendish* was to improve certainty for parties and decrease transaction costs associated with litigation, should parties be permitted to claim damages and take a 'second bite at the cherry'?

The SLC took the view that there was no bar to the cumulation of a penalty with other remedies provided they were "not inconsistent" with each other and suggested that it would be theoretically possible for a creditor to claim damages for losses above the amount of a penalty.[394] This accords with the position taken in relation to the cumulation of remedies in Scots contract law. For example, a pursuer might seek specific implement for a contract to sell their house, in addition to damages for the loss caused by delay.[395] Likewise, where losses exceed a penalty provision, it seems consistent for them to be added to what the pursuer can recover via damages.

In contrast, in English law, the position is that where a liquidated damages clause is not a penalty, a party's recovery is restricted to the stipulated sum but a penalty clause will not cap damages.[396] Burrows has argued that where a provision is deemed a penalty, a pursuer should not be able to claim damages beyond the sum stipulated.[397] Burrows contends that otherwise, claimants who have unfairly inserted the penalty clause would be in a more advantageous position compared to a claimant who has acted fairly and

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[390] *Lord Elphinstone* v *Monkland Iron and Coal Co Ltd* (1886) 13 R (HL) 98 at108 per Lord Fitzgerald.
[391] *Dingwall* v *Burnett* 1912 SC 1097 at1106-1107 per Lord Salvesen.
[392] *Dunlop Pneumatic Tyre Company* v *New Garage and Motor Company* [1915] AC 79 at 86 per Lord Dunedin.
[393] *Cavendish* at paras 28 and 31 per Lords Neuberger and Sumption; paras 152 and 198 per Lord Mance; para 248 per Lord Hodge.
[394] Discussion Paper on *Penalty Clauses* (Scot Law Com No 162, 2016) para 5.79.
[395] Hector L MacQueen, *Contract Law in Scotland*, 6th edn (2020) para 6.6.
[396] *Cellulose Acetate Silk Co* v *Widnes Foundry Ltd* [1933] AC 20, at 25 per Lord Atkin; *Watts, Watts & Co Ltd* v *Mitsui & Co Ltd* [1917] AC 227 at 235 per Lord Chancellor Finlay.
[397] Burrows (n 229) 394.

inserted a liquidated damages clause.[398] Furthermore, Burrows points out, permitting recovery "also encourages the inclusion of penalty clauses, since the claimant can take the advantage of having the clause, without suffering any disadvantage."[399]

Overall, the view taken here is that recovery should be capped at the stipulated sum, regardless of whether it is held to be a liquidated damages clause or a penalty. Fundamental to the *Cavendish* reformulation was promoting greater certainty for contracting parties and reducing transaction costs associated with litigation. Introducing the cap would effectively advance those aims, ensuring that parties do not waste money invested in negotiating liquidated damages clauses.

(3) The protective function of the penalty doctrine

(a) Particular characteristics of debtors

In *Cavendish*, the Supreme Court found that if both parties (i) had access to legal advice, and (ii) were of equal bargaining power, there would be a "strong initial presumption" that a stipulation was not a penalty.[400] While these factors are important, it is suggested that there could be room for other relevant factors when the contracting parties are consumers. Although penalty clauses are primarily relevant in commercial cases, as *ParkingEye Ltd* v *Beavis* shows, the penalty doctrine is potentially applicable to consumers.[401] For example, the facts of the Scottish case *Indigo Park Services UK Ltd* v *Watson* were very similar to the facts of *ParkingEye* v *Beavis*.[402]

It could be argued that consumers are provided with adequate protection by the Consumer Rights Act 2015, which contains protections for consumers. There is, as a result, no need to reform the penalty doctrine to protect consumers.[403] Under the 2015 Act, terms are unfair if, contrary to the requirement of good faith, they cause a significant imbalance in the parties' contractual rights to the detriment of the consumer.[404] Factors taken into account when determining whether a clause is unfair include (a) the nature of the subject matter of the contract, and (b) the circumstances when the term was agreed to in addition to the other terms of the contract. Schedule 2 specifically states that a provision which requires a consumer to pay a "disproportionately high sum in compensation" for failing to fulfil their obligations under

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[398] Burrows (n 229) 394.
[399] Burrows (n 229) 394.
[400] *Cavendish* at paras 35 per Lords Neuberger and Sumption.
[401] *Cavendish*.
[402] *Indigo Park Services UK Ltd* v *Watson* 2017 GWD 40-610 at para 46 per Sheriff Drummond; Sirko Harder, "The Rule Against Contractual Penalties in Great Britain and Ireland" (2019) 11(1) European Journal of Commercial Contract Law 1 at 11.
[403] Morgan (n 221) at 14; s62(1) Consumer Rights Act 2015.
[404] S62(4) Consumer Rights Act 2015.

the contract may be regarded as unfair.[405] Given the considerable overlap in scope between the 2015 Act and the penalty doctrine, this raises the question of whether the penalty doctrine is redundant in protecting consumers.

In *ParkingEye* v *Beavis*, Mr Beavis' other ground of appeal was that the fine was unfair under the Unfair Terms in Consumer Contracts Regulations 1999 (the predecessor to the 2015 Act).[406] The 2015 Act simply replicated the terms of the earlier regulations.[407] By majority, the Supreme Court held that the £85 was not unfair for the purpose of the 1999 Regulations.[408] Lords Neuberger and Sumption stated that "the same considerations which show that the £85 charge is not a penalty demonstrate that it is not unfair for the purpose of the Regulations."[409] They found that ParkingEye had a "legitimate interest" in imposing the charge to induce Mr Beavis to observe the two-hour limit and enable other customers to use the parking space.[410] Applying the objective test of whether ParkingEye could reasonably assume that the consumer would have agreed to such a term in individual contract negotiations, Lords Neuberger and Sumption concluded that a reasonable motorist would have agreed.[411] Other relevant factors identified by Lords Neuberger and Sumption were that the terms were prominently displayed, there was no pressure to accept the terms, the benefit to other motorists, and the fact the £85 charge was comparable to charges levied by local authorities for parking in public car parks.[412]

However, Lord Toulson dissented, emphasising that the onus lay on ParkingEye to prove that a consumer in individual negotiations would have agreed to the terms.[413] Lord Toulson disagreed with Lords Neuberger and Sumption for "substitut[ing] their judgment of reasonableness of the clause" for "whether the supplier could reasonably have assumed that the customer would have agreed with the term."[414] Lord Toulson determined that by doing so, "there [was] not much, if any, difference in substance from the test whether it offended the penalty doctrine at the common law."[415] Also, as Lord Toulson highlighted, that is consistent with Lord Neuberger and Sumption's statement that their approach to the 1999 Regulations involved the same considerations as their

[405] S63(1) and Part 1 Schedule 2 paragraph (5) Consumer Rights Act 2015.
[406] *Cavendish* at para 1 per Lords Neuberger and Sumption.
[407] Regulations 5(1) and 6(1) Unfair Terms in Consumer Contracts Regulations 1999.
[408] *Cavendish* at para 104 per Lords Neuberger and Sumption); para 213 per Lord Mance; para 289 per Lord Hodge.
[409] *Cavendish* at para 104 per Lords Neuberger and Sumption.
[410] *Cavendish* at para 107 per Lords Neuberger and Sumption.
[411] *Cavendish* at para 108 per Lords Neuberger and Sumption.
[412] *Cavendish* at paras 108-109 per Lords Neuberger and Sumption.
[413] *Cavendish* at para 314 per Lord Toulson.
[414] *Cavendish* at para 314 per Lord Toulson.
[415] *Cavendish* at para 314 per Lord Toulson.

approach to the penalty doctrine.[416] According to Lord Toulson, this "water[ed] down the test adopted by the CJEU."[417]

The approach to the penalty doctrine and the 1999 Regulations taken by the majority in *Cavendish* has attracted academic criticism. As Giliker points out, the £85 charge was seen as a "commercially legitimate sum" from the perspective of ParkingEye but from the perspective of a pensioner who returns one minute late, it can be seen as "quite harsh."[418] DiMatteo has contended that the charge was more of a "trap" for consumers.[419] When considering whether the penalty doctrine was "superfluous" in the consumer context, Halson found it relevant that the application of both the penalty doctrine and the statutory regime led to the same outcome.[420] Given these criticisms, this dissertation takes the view that the provisions of the 2015 Act are insufficient to provide consumers with robust protection from penalties. In order to address some of these criticisms, the following section considers whether an historic part of Scots law, the law regulating extortionate credit bargains/unfair credit relationships, could be used as inspiration for a new approach.

Previously, under the Consumer Credit Act 1974, the court had powers to re-open extortionate credit bargains.[421] This was repealed by the Consumer Credit Act 2006 as the provisions were deemed a "disappointment", with fewer than 30 cases having been brought to court, none in Scotland, and few cases decided in favour of consumers.[422] Under the new regime, the court may make an order in connection with a credit agreement where the relationship between creditor and debtor is unfair because of (a) any terms of the agreement, (b) the way the creditor has exercised/enforced its rights, or (c) any other thing done by, or on behalf of the creditor.[423] When making a determination, the court "shall have regard to all matters it thinks relevant."[424] The new provisions could be criticised for being drafted too broadly to act as a source of inspiration for more particular factors that could be adopted by the penalty doctrine.

However, the old regime did contain some interesting elements which could be used as relevant factors for the court to take into account when determining whether stipulations affecting consumers are penalties. The powers under the 1974 Act permitted the court

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[416] *Cavendish* at para 314 per Lord Toulson.
[417] *Cavendish* at para 314 per Lord Toulson.
[418] P Giliker, "Case Note England and Wales, UKSC 4 November 2015, Cavendish Square Holdings BV v. Makdessi; ParkingEye Ltd v. Beavis" (2017) 25(1) European Review of Private Law 173 at 180.
[419] DiMatteo (n 8) at 446.
[420] R Halson and Q Liu, "Agreed Damages, The Penalty Rule and Unfair Terms: An Anglo-Australian and Chinese Comparison" (2019) 7(1) Chinese Journal of Comparative Law 49 at 83.
[421] S138 Consumer Credit Act 1974.
[422] SS140A-C Consumer Credit Act 1974; L Macgregor, D J Garrity, J Hardman, A DJ MacPherson, and L Richardson, *Commercial Law in Scotland*, 6th edn (2018) para 3.8.7.
[423] S140A(1) Consumer Credit Act 1974.
[424] S140A(2) Consumer Credit Act 1974.

to “reopen the credit agreement so as to do justice between the parties.”[425] A credit bargain was deemed extortionate if it (a) required the debtor to make “grossly exorbitant” payments, or (b) “otherwise grossly contravene[d] ordinary principles of fair dealing.”[426]

Factors taken into consideration to determine whether a credit bargain was extortionate were (a) interest rates at the time the bargain was struck, (b) characteristics of the debtor and creditor, and (c) any other relevant considerations.[427] The characteristics of the debtor highlighted by the legislation were “(a) his age, experience, business capacity and state of health; and (b) the degree to which, at the time of making the credit bargain, he was under financial pressure, and the nature of the pressure.”[428] Relevant characteristics of the creditor were “(a) the degree of risk accepted by him, having regard to the value of any security provided; (b) his relationship to the debtor; and (c) whether or not a colourable cash price was quoted.”[429]

The original provisions contain a degree of similarity to the penalty doctrine. Most obvious is the proportionality element – the regime applied to “extortionate” credit bargains, where the payments required were “grossly exorbitant.” The ability of the courts to reopen extortionate credit bargains is also strikingly similar to the power of modification in the context of the penalty doctrine.[430]

Despite these similarities, the old extortionate credit bargain regime provided much greater protections to the debtor than the post-*Cavendish* penalty doctrine. For example, a bargain was held to be extortionate if it met the lower threshold of grossly contravening the “ordinary principles of fair dealing.” Furthermore, the court reopened the agreement so as to do “justice” between the parties, which seems to go further than the power of modification under the penalty doctrine. Finally, the court would carry out a more subjective approach, taking into account the debtor’s particular characteristics.

It has been argued that the power to vary terms was justifiable in the consumer credit context given the potential consequences to the consumer otherwise.[431] Equally, the Consumer Rights Act 2015 provides consumers as a class with additional protections relating to the sale of goods, as they are perceived to be more vulnerable to

[425] S137(1) Consumer Credit Act 1974.
[426] S138(1) Consumer Credit Act 1974.
[427] S138(2) Consumer Credit Act 1974.
[428] S138(3) Consumer Credit Act 1974.
[429] S138(4) Consumer Credit Act 1974.
[430] L Macgregor, “The Effect of Unexpected Circumstances on Contracts in Scots and Louisiana Law” in V Palmer and E Reid (eds), *Mixed Jurisdictions Compared: Private Law in Louisiana and Scotland* (2009) 244 at 276.
[431] L Macgregor, “Illegal Contracts and Unjustified Enrichment” (2000) 4(1) Edinburgh Law Review 1 at 42.

exploitation.[432] In *Cavendish*, the Supreme Court acknowledged that unequal bargaining power could affect both consumers and business-to-business contracts.[433]

However, consumers suffer from other disadvantages too: the traditional argument is that consumers are generally less knowledgeable and in a weaker economic position than commercial entities, and sellers are likely to exploit the information and economic asymmetry.[434] Although this view has been subject to academic criticism, it nevertheless remains a conceptual force in Scots contract law, a fact borne out by the Consumer Rights Act 2015.[435] Consequently, it might be argued that consumers ought to receive further protection in relation to the operation of the penalty doctrine, which currently treats consumers and commercial entities in the same way.

Moreover, as established in Chapter II, the penalty doctrine's origins in Scots law can be traced to attitudes against usury, i.e., from its inception, it has been concerned with protecting debtors from excessive punishments. Also, given that in some instances consumers require additional protections, it may be appropriate for reform to enhance protections for consumers, now that the ambit of the penalty doctrine has been greatly reduced by the new *Cavendish* formulation.

To address this, some of the elements of the old regime on extortionate credit bargains could be used as inspiration to protect consumers/employees in the context of the penalty doctrine. This could include adopting a lower threshold for the proportionality aspect of the penalty doctrine, or applying a subjective test and considering the particular characteristics of the consumer when deciding whether a stipulated sanction is a penalty.

(b) Equitable control of retention and specific implement

Having identified a potential reform to protect consumers, this section considers a broader reform to enable the Scottish courts to protect debtors more generally. Specifically, this section focuses on whether the stipulation's effect on the debtor could provide a justification for a court to refuse enforcement of a creditor's contractual entitlement. Under the *Cavendish* conception of the legitimate interest test, the proportionality requirement can be described as 'internal' in the sense that the sanction

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[432] Consumer Rights Act 2015.
[433] *Cavendish Square Holding BV* v *Makdessi*; *ParkingEye Ltd* v *Beavis (Consumers' Association Intervening)* [2015] UKSC 67, [2016] AC 1172 at para 38 per Lords Neuberger and Sumption; L A DiMatteo, "An Examination of Judicial Reasoning – When a Penalty Is Not a Penalty" (2017) 85(6) The George Washington Law Review 1846 at 1902.
[434] S Weatherill, *EC Consumer Law and Policy* (1997) 60.
[435] Stefan Haupt, *An Economic Analysis of Consumer Protection in Contract Law* (2003) 1138.

must be proportionate to the creditor's legitimate interest.[436] However, this section suggests that it would be appropriate to introduce another dimension to the proportionality condition: whether the stipulation will cause significant hardship to the debtor. This aspect of the proportionality test could be described as 'external' in the sense that it considers a factor outside of the creditor's interests.

This factor could be applied under the Scottish court's equitable jurisdiction. As established in Chapter VI, equity is suffused through Scots contract law and provides the basis for the court's 'dispensing power' to 'correct' strict law, manifested in the context of the penalty doctrine by the power of modification. This power is limited in the sense that it only applies where a sanction has been found to be a penalty.[437]

Yet, there appears to be no reason why the court could not also exercise its equitable jurisdiction to refuse enforcement of a creditor's right to receive a stipulated sanction that would cause the debtor excessive hardship. Conceptually, this would have the benefit of supporting the rationale underlying the court's equitable jurisdiction. From a doctrinal perspective, adding this external aspect to the proportionality assessment would harmonise the penalty doctrine with certain existing Scots contract law remedies. For example, chapter V identified this mechanism in the context of both specific implement and the rules regulating performance after repudiation. Another relevant example is retention, in which we can see the court's equitable powers at work, although in a slightly different manner.[438]

It is clear that retention cannot be exercised in an abusive or unfair manner.[439] In *Aberdeen City Council v McNeill,* Lord Drummond Young held that the court should use their "equitable control" and that "in any particular case the court may exercise a discretion as to whether retention should be permitted to operate" to prevent it from becoming an "instrument of abuse."[440] It is unclear what exactly will be considered an inequitable use of retention, as Lord Drummond Young stated that he "would not wish to circumscribe the circumstances that may be relevant."[441] The phrase "in any particular case" also appears to provide the court with a wide discretion. As Richardson notes, this

[436] *Cavendish* at para 32 per Lords Neuberger and Sumption; para 152 per Lord Mance; para 255 per Lord Hodge.
[437] *Wright* v *M'Gregor* (1826) 4 S 434 at 436 per Lord Alloway.
[438] *Aberdeen City Council* v *McNeill* 2013 [CSIH] 102, 2014 SC 312 at para 30 per Lord Drummond Young; *Anderson* v *Brattisanni* 1978 SLT (Notes) 42 at 44 ().
[439] *McNeill* at para 30 per Lord Drummond Young.
[440] *McNeill* at para 30 per Lord Drummond Young.
[441] *McNeill* at para 30 per Lord Drummond Young.

equitable control has been somewhat neglected over the last century, but has received attention in some significant recent cases.[442]

Nevertheless, some examples have been suggested. In *McNeill*, Lord Drummond Young pointed out that the purpose of retention is to compel future contractual performance, and stated that if retention was "invoked for some other purpose, it may well be appropriate to hold that its exercise is inequitable."[443] For this reason, Lord Drummond Young also found that retention cannot generally be exercised "in respect of a breach of contract that has occurred in the past and is unlikely to be repeated."[444] Another example is that the court will be more likely to intervene in relation to particular classes of contract, such as employment contracts, the context in *McNeill*. At an abstract level, the first example is comparable to the legitimate interest test – penalty clauses will not be enforced where their purpose is to punish the debtor, as that was specifically identified by the Supreme Court as not constituting a legitimate interest. The final example, concerning particular classes of contracts being treated differently, has been addressed in the previous subsection.

Lord Drummond Young's second example was that retention cannot generally be exercised in respect of past breaches unlikely to be repeated, given that the purpose of retention is to compel future performance. Applying this argument by analogy to the penalty doctrine, one of the accepted legitimate interests in a liquidated damages clause post-*Cavendish* is to compel performance of obligations, as is the case with retention.[445] By analogy with *McNeill*, it could be argued that it would be inequitable to enforce penalty clauses aiming to secure performance for minor past breaches that are unlikely to be repeated.

As with retention, the court also has a right to refuse to grant specific implement where it would be "inequitable" or cause undue hardship to the defender disproportionate to the benefits to the pursuer.[446] The discretion has only been exercised in a small number of cases, often where an owner asks a court to order removal of an encroachment.[447]

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[442] Richardson (n 294) at 219; *Inveresk plc* v *Tullis Russell Papermakers Ltd* [2010] UKSC 19 para 43 per Lord Hope; *J H & W Lamont of Heathfield Farm* v *Chattisham Ltd* [2018] CSIH 33 at para 44 per Lord Drummond Young.
[443] *McNeill* at para 30 per Lord Drummond Young.
[444] *McNeill* at para 29 per Lord Drummond Young; but see criticism of this approach in L Richardson "What Do We Know about Retention Now?" (2018) 22(3) Edinburgh Law Review 387 at 391 and L Richardson, "Set-off: A Concept Divided by a Common Language?" (2017) (2) Lloyd's Maritime and Commercial Law Quarterly 238 at 254-255.
[445] *Cavendish Square Holding BV* v *Makdessi*; *ParkingEye Ltd* v *Beavis (Consumers' Association Intervening)* [2015] UKSC 67, [2016] AC 1172 at para 248 per Lord Hodge.
[446] MacQueen and Macgregor (n 259) at 128; Macgregor (n 227) at 75; *Moore* v *Paterson* (1881) 9 R 337 at 352 per Lord Shand (obiter); *Macnair* v *Cathcart* (1802) Mor 12832 at 12833 per Lord Armadale; *Jack* v *Begg* (1875) 3 R 35 at 43 per Lord Gifford; *Wilson* v *Pottinger* 1908 SC 580 at 586 per Lord President Dunedin.
[447] Macgregor (n 227) at 75.

For example, in *Anderson* v *Brattisanni*, the Inner House exercised its equitable jurisdiction to refuse specific implement where the award "would be attended with unreasonable loss and expense quite disproportionate to the advantage which it would give to the successful party."[448] The Inner House also noted that the power was to be exercised sparingly, so there is a high bar to pass before the court will exercise its equitable power.[449]

Overall, while the jurisprudence on the equitable control of retention does not contain an exhaustive list of relevant factors, it is clear that the court will intervene where allowing a party to exercise retention would be abusive. Specific implement provides a more helpful example of when the court's dispensing power will be exercised compared to retention, evaluating the proportionality between the benefit to the creditor and the cost to the debtor.

To summarise, this section argues in favour of expanding the court's equitable jurisdiction in order to allow the court to refuse to enforce stipulations, despite satisfying the legitimate interest test, on the basis that it would provide benefits to the creditor out of all proportion to the disadvantages to the debtor. Introducing this external facet to the proportionality assessment would provide an additional safeguard against abuse of debtors which may be valuable considering the much narrower scope of the penalty doctrine post-*Cavendish*. It would also promote doctrinal cohesion between the penalty doctrine and other remedies in Scots contract law.

(4) Conclusion

Having accepted that *Cavendish*, while not formally authoritative, is being followed by the Scottish courts, this chapter has presented a critical analysis of the legitimate interest test, and suggested potential reforms. In particular, this chapter has evaluated the legitimate interest test with reference to the underlying rationales of the penalty doctrine: (1) providing parties with certainty and avoiding transaction costs, and (2) protecting debtors from exorbitant sanctions. The ambiguity over what constitutes a legitimate interest has been criticised, especially given that the Cavendish reformulation was partially justified on the basis of promoting greater certainty for contracting parties.

The divergent conceptual basis for the penalty doctrine also raises questions about its relationship with damages. Under the historic authority for the genuine pre-estimate of loss test, damages would not be capped by a liquidated damages clause. Yet, it has been suggested that, given the emphasis on promoting certainty for parties and reducing the likelihood of litigation, a stipulated sanction should act as a cap on

[448] *Anderson* at 44.
[449] *Anderson* at 44.

damages – regardless of whether it is a penalty or liquidated damages clause. This could also potentially counteract the uncertainty caused by the introduction of the new legitimate interest test.

Additionally, as established in Chapter III, *Cavendish* has significantly narrowed the scope of the penalty doctrine, making it more difficult for courts to interfere with liquidated damages clauses. Given that part of the purpose of the penalty doctrine is to protect debtors from extortionate stipulations, it may be appropriate to consider the position of consumers, which are treated by Scots contract law as a class requiring additional protections. In view of their weakened position, it may be appropriate to take into account some of the factors listed under the old extortionate credit bargain regime when determining whether a clause is a penalty, or introducing a lower threshold for the proportionality assessment for consumers.

A related point is the current lack of an external element to the proportionality assessment, which would take into account whether the stipulation causes undue hardship to the debtor. The analogies of retention and specific implement illustrate that the courts will use their discretion to prevent parties from exercising their legal rights where to do so would be inequitable. Alongside promoting doctrinal coherence amongst the contractual remedies, introducing this external facet to the proportionality test would also support the function of the penalty doctrine of preventing abuses.

H. CHAPTER VIII – CONCLUSION

Overall, this dissertation has demonstrated that *Cavendish* is almost certainly going to be followed by the Scottish courts, and that adopting the legitimate interest test will represent a dramatic change in the Scottish approach to the penalty doctrine. The orthodox approach to the penalty doctrine, based on whether it was a genuine pre-estimate of loss, was over a century old – with even older roots going back to canon law's disapproval of usury. As the analysis in Chapter IV illustrates, the "creative" attempts to reconcile the legitimate interest test with existing Scots precedent is perhaps a stretch.[450] Furthermore, much of the reasoning in *Cavendish* is built upon the commercial justification cases, for which there is no Scottish equivalent.

A key conclusion of the dissertation is that the ambiguity over what constitutes a legitimate interest is highly unsatisfactory.[451] Yet, some common factors that are relevant when determining whether a clause is a penalty can be identified. Rowan set out five main considerations: the importance of the term breached, the "seriousness of

[450] MacQueen (n 2) at 72.
[451] *Moises Gertner & Laser Trust* v *CFL Finance Ltd* [2020] EWHC 1241 (Ch), [2020] CTLC 241 at para 137 per Smith J.

the consequences of its breach, the impact on the interests of third parties, the protection of public interest, the protection of non-financial expectations, and the presence or absence of certain characteristics in the contracting parties."[452] Another factor which has been relevant in the cases following *Cavendish* is comparison with market rates.[453]

Nevertheless, the definition of legitimate interest in *Cavendish* is unsatisfactory. The definition is negative – it states that punishment is not a legitimate interest.[454] Furthermore, following *Cavendish*, deterrence is not necessarily penal where there is a "legitimate interest in influencing the conduct of the contracting party."[455] Day has questioned whether deterrence can ever not be penal, and whether this means that the courts will essentially enforce penalties considered proportionate.[456] This marks a dramatic shift in the conceptual basis of the penalty doctrine in Scots contract law, given that previously only compensation was permitted as a ground of recovery.

One of the central questions of this dissertation was whether there was a general concept of legitimate interest across Scots contract law. The concept of legitimate interest was described in *Cavendish* as a mechanism controlling the availability of remedies for breach of contract, with reference to specific performance and whether a party can insist on performance following repudiation. There appears to be similarity between specific implement, insisting on performance following repudiation, and legitimate interest in the context of penalties

In the context of specific implement and insisting on performance following repudiation, the ground for controlling the availability of remedies is the Scottish court's equitable jurisdiction. There are also some key differences in the way the Scottish court's equitable jurisdiction operates in these areas of Scots contract law compared to English contract law. Most significant is the fact that the *Cavendish* concept of legitimate interest considers whether damages would provide an adequate remedy. In contrast, in the Scottish examples, the parties have a legal right to the particular remedy, and the adequacy of damages is not a consideration. Therefore, to the extent that following *Cavendish* will introduce the concept of legitimate interest into Scots contract law, it will have an important effect on the taxonomy of remedies for breach of contract, introducing a degree of hierarchy between liquidated damages clauses and damages. This raises questions about how the genuine pre-estimate of damages would continue

[452] Rowan (n 7) at 150.
[453] *Cargill International Trading Pte Ltd* v *Uttam Galva Steels Ltd* [2019] EWHC 476 (Comm) at paras 54 and 56 per Bryan J.
[454] *Cavendish Square Holding BV* v *Makdessi*; *ParkingEye Ltd* v *Beavis (Consumers' Association Intervening)* [2015] UKSC 67, [2016] AC 1172, at para 31 per Lords Neuberger and Sumption.
[455] *Cavendish* at para 99 per Lords Neuberger and Sumption.
[456] Day (n 96) at 236.

to operate in simple cases in Scots law, where parties have a recognised performance interest.

Another question raised by *Cavendish* concerns the way in which the Scottish court's equitable power of modification will operate. Currently, the power of modification restricts recovery to compensation. It is unclear whether the power of modification could restrict recovery to compensation even where a party is found to have a legitimate interest beyond compensation. There is also uncertainty regarding the way in which the power of modification operates in relation to penalties ancillary to obligations *ad factum praestandum*.

Finally, this dissertation has identified some potential paths going forward for the Scottish approach to the penalty doctrine. Having determined that Scots law almost definitely will follow *Cavendish*, although it is only persuasive, some options for reform have been suggested. One significant problem is that one of the main justifications for the Cavendish reformulation was to improve certainty for contracting parties, and arguably that objective has been largely frustrated by the ambiguity surrounding the legitimate interest test. It has been suggested that certainty of outcome could be improved for contracting parties by capping damages at the amount stipulated in penalty/liquidated damages clauses. This would improve certainty by reducing the likelihood of litigation, and hence also save on transaction costs. This would also cohere with one of the two main historic rationales for the penalty doctrine: providing parties with certainty and helping them save costs of litigation.

The other main justification for the penalty doctrine is the protection of parties from exorbitant sanctions. It has been suggested that there is a need to balance the reduction in the scope of the penalty doctrine by improving the protection offered by the penalty doctrine in other ways. As a class, consumers are treated differently by Scots contract law due to their perceived vulnerability. To support the objective of protecting consumers, the penalty doctrine could be amended to take into account their subjective characteristics. Alternatively, a lower threshold for the proportionality test could be adopted. On a broader level, it is also argued that the Scottish court's equitable jurisdiction should be used as a basis to introduce another stage to the proportionality analysis. Evaluating the effect on the defender as part of the proportionality analysis would provide more robust protection to defenders, and ensure that the penalty doctrine was more doctrinally consistent with other remedies for breach of contract in Scots law.

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