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The Newsletter of the Technology and Construction Bar Association

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Chairman's Message

I open this issue by thanking all the speakers and attendees at our annual conference on 30 January. I am particularly grateful to our President, Lord Dyson MR, for his keynote address.

I would also like to take this opportunity to congratulate Terry Bergin and Alexander Hickey of 4 Pump Court, Kim Franklin of Crown Office Chambers, and Riaz Hussain of Atkin Chambers on their recent appointment as Queen's Counsel.

Looking forward, I would like to comment on two aspects relevant to our junior members. First, I am grateful to Tom Ogden of 4 New Square for organising TECBAR's response to the questionnaire sent by Nicholas Bacon QC, the Chair of the Bar Council's Working Group, on Lord Justice Jackson's recent proposals for fixed fees in cases valued at less than £250,000. There has been an encouraging response from junior members on these potentially very significant proposals.

Second, I would like to remind TECBAR members of less than seven years' call of TECBAR's partnership with the Bar Council in the International Legal and Professional Development Grant Programme. The purpose of the programme is to support our junior members in attending international legal events or conferences to further their professional development. Grants are available from TECBAR for international events before the end of 2016.

The next deadline for applications is 5pm on 10 June 2016. Further information about the Programme, together with the application documents, may be found on the Bar Council's website. Completed applications should be sent to our Secretary, Lynne McCafferty of 4 Pump Court.

Moving on to upcoming events, I remind all TECBAR members that the conference organised jointly by TECBAR and the Dispute Board Federation, which was due to take place on 31 March – 1 April 2016 in Hanoi, Vietnam and which was advertised in the last issue, will now not be taking place.

However, as always, all TECBAR members are encouraged to attend our AGM and Annual Garden Party at Skinners' Hall on 21 July 2016. Further details will be circulated in due course.

Martin Bowdery QC,
Atkin Chambers

From the Editor

This Spring 2016 issue of the *TECBAR Review* contains three contributions, each discussing a recent case of relevance to TECBAR members.

The first, by Robert Scrivener of 4 Pump Court, is an appraisal of the present state of the law on concurrent duties in contract and tort in light of the recent decision in *Burgess and Burgess v Lejonvarn* [2016] EWHC 40 (TCC).

In the second, Nicholas Maciolek of Atkin Chambers comments on the decision *in Grove Developments Limited v Balfour Beatty Regional Construction Limited* [2016] EWHC 168 (TCC) and its clarification, among other things, of the circumstances in which the Scheme for Construction Contracts may be implied into the parties' agreement on payment terms.

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Finally, pupil barrister Mathias Cheung contributes a case-note on the Supreme Court's decision in the combined cases of *Cavendish Square Holding BV* v *Talal El Makdessi* and *Parking Eye Ltd* v *Beavis* [2015] UKSC 67 and its re-assessment of the limits and rationale of the doctrine of penalties.

I am sure TECBAR members join me in congratulating Mathias on winning First Place in the 2016 Hudson Prize for his essay on the *Makdessi* decision, *Shylock's Construction Law: The Brave New Life of Liquidated Damages?* The essay is to be published shortly.

Christopher Reid, Atkin Chambers

Contract, tort, and construction

Over 20 years since *Henderson v Merrett*, and the boundary between contract and tort continues to be a difficult one to define. The TCC has, frequently, been required to consider that boundary. It did so most recently in *Burgess v Lejonvarn* [2016] EWHC 40 (TCC).

In that case, the claimant alleged that the defendant had performed architectural services in relation to a landscaping project, and owed him contractual and tortious duties when carrying those out.

The Judge rejected the contractual claim for three reasons. First, the services were gratuitous, so there was no consideration. Second and thirdly, the parties had not reached a sufficiently certain agreement, and nor was there an intention to create legal relations.

However, he did find there was a duty of care in tort, the scope of which extended to various matters relating to the selection of contractors, the preparation of designs, and so on.

This short article tries to place *Burgess* in context in respect of pure economic loss claims.

Contract and tort

As Jackson LJ reminded us in *Robinson v Jones*, contractual and tortious obligations have different legal sources.[1] This approach is consistent with modern private law theory, which would split the law into separate "events" which give rise to separate "obligations" in response.[2]

This way, the division between contract and tort should be clear. The "event" which gives rise to a contract is an agreement. The "event" which gives rise to tortious obligations is a "wrong". Thus, unlike contractual obligations, tortious obligations are imposed by law, and not the consent of the parties.[3]

In the real world, however, things are not quite so clear cut. Matters have become complicated by the fact that a contract can give rise to duties in tort, whether these be concurrent[4] or owed to third parties.[5] That problem is not helped by the fact that one way for deciding whether there is a duty of care is to ask if there was an assumption of responsibility.[6] This test is almost bound to look, on at least some level, at what the parties agreed (even just tacitly). Questions of consent and agreement are, therefore, highly relevant for deciding whether a duty of care was owed.

There are two different types of case to consider:

(a) Where a claimant has a contract with a defendant, but nonetheless tries bringing a tortious claim.

(b) Where a claimant does not have a contract with a defendant, so can only bring a tortious claim.

Where there is a contract

This type of case gives rise to the familiar problem of concurrent liability. It is widely accepted that, whilst it is always open to a claimant to choose their most favourable cause of action, they should not be able to rely on tort if that would undermine what they have agreed under the contract.[7] In similar vein, the Court of Appeal has recently held that, if there is to be concurrent liability, then in the event of a conflict between the contractual and tortious tests for remoteness of damage, the former should prevail.[8]

The leading (construction) case on whether there can be concurrent liability is, of course, *Robinson v Jones*.[9] The well-known facts concerned a claim against a builder who, it was alleged, had negligently constructed chimney flues. Limitation in contract had expired, but by virtue of s.14A of the Limitation Act, a tortious claim would be in time.

1 [2012] QB 44, paragraph 79.

2 See, e.g., P. Birks *Unjust Enrichment* (2nd Ed.), chapter 2 (*"Three Maps"*).

3 See P. Winfield at p. 32 of *The Province of the Law of Tort* (1931): *"Tortious liability arises from the breach of a duty primarily fixed by the law; such duty is towards persons generally…"*.

4 *Henderson v Merrett* [1995] 2 AC 145.

5 *White v Jones* [1995] 2 AC 207.

6 So too with asking whether the relationship was "akin to contract".

7 There are many examples. One of the more emphatic is *Central Trust Co. v Rafuse* (1986) DLR (4th), 481, 521 – 522 : *"A concurrent or alternative liability in tort will not be admitted if its effect would be to permit the plaintiff to circumvent or escape a contractual exclusion or limitation of liability for the act or omission that would constitute the tort. Subject to this qualification, where concurrent liability in tort and contract exists the plaintiff has the right to assert the cause of action that appears to be most advantageous to him in respect of any particular legal consequence"*.

8 *Wellesley v Withers* [2015] EWCA Civ 1146.

9 For earlier cases, see *Ove Arup v Mirant Asia-Pacific (No.2)* [2005] PNLR 10 (engineer with design responsibility owed a duty of care in respect of pure economic loss) *Payne v John Setchell Ltd.* [2002] PNLR 7 (engineer with design responsibility did not owe a duty) and *Storey v Charles Church Developments Ltd.* 73 Con LR 1 (designer owed a duty).

However, the Court of Appeal[10] thought no duty of care existed. There had been no assumption of responsibility. "*Professional persons*" could be taken to have assumed responsibility, since they give advice, and expect their clients to rely on them.[11] But that was not the case here: the contract was "*normal*", and the defendant was simply to build to an agreed plan.

The test the Court of Appeal posed was, in effect, to ask whether the defendant was being relied on. That would (often) be the case where design work was in question, as where other "*professional persons*" were engaged, but not in the case of a builder.[12] However, it is not clear why a careless builder should be in any better position than a careless architect. There is no "magic" in design, and many decisions that have to be made in a construction project can be seen as design choices.[13]

Further, *Robinson* fails to explain *why* professional advice (such as that given by an architect) justifies a duty, whereas "mere" building work does not.[14] The importance given to the question of whether a person was a "*professional*" is unsatisfactory.[15] If we are to have concurrent liability, a better approach would be to do away with any reliance on the concept of whether the defendant was a "*professional person*".[16] The focus should always be on whether the duty would be inconsistent with the contract, and those parts of *Robinson* that adopt this approach are to be welcomed.

Where there is no contract

On the face of it, this type of case should not give rise to the same problems as concurrent liability. After all, if there is no contract between the parties, how can the imposition of a tortious duty undermine what they have (not) agreed?

However, there will often be a deliberate reason why the parties are not in a contractual relationship. Thus, there is no contract between an employer and sub-contractor because they placed the contractor in the middle. They should not then be allowed to complain when (for whatever reason) their rights against that contractor appear unsatisfactory to them.

That no tortious duty is imposed in such a situation is well-established. An early case was *Simaan v Pilkington Glass Ltd.*[17] There, the claimant contractor had sub-contracted the supply and erection of curtain walling. The sub-contractor in turn engaged the defendant to supply the materials. When the defendant supplied unsatisfactory materials, the claimant could not recover in tort for the financial loss they suffered from this. According to Sir Thomas Bingham M.R., the claimant did not rely on the defendant (the latter was simply performing its contract) and it was not just and reasonable to impose a duty.[18]

A more recent example is *Sainsbury's Supermarkets Ltd. v Condek Holdings Ltd.*[19] Here, and following earlier authority,[20] Stuart-Smith J held that structural engineers (engaged by the contractor) did not owe the employer a duty in respect of their design works. He considered that, as with a sub-contractor who provides work and materials, a sub-contracted designer does not normally assume responsibility to the employer. The case is notable because, as stated, the defendant was a "*professional person*" of the type discussed in *Robinson*. It thus might have been thought more likely to owe a duty than a sub-contractor acting as builder alone.[21]

Not all cases go the same way, however. In *Jarvis & Sons Ltd. v Castle Wharf Developments Ltd.*,[22] the Court of Appeal held there was no reason in principle why a project manager engaged by the employer could not become liable to a contractor for negligent mis-statements made in respect of the tendering process. One justification for this finding might be that there was no contract between employer and contractor at the time of the mis-statements,[23] and so no contractual chain could be undermined.[24]

There are also the hard cases of *IBA v EMI*[25] and *Junior Brooks Ltd. v Veitchi Co. Ltd*.[26] However, in the former, the duty question was conceded. The latter, at least until the Supreme Court has a chance to overrule it, is best seen as confined to its own facts. In general terms, no duty of care should be owed where this would cut across the contractual structure.[27]

10 Which included Jackson L.J., who has given a cool reaction to concurrent liability: see *Concurrent Liability: Where Have Things Gone Wrong?* (TECBAR lecture, 30 October 2014).

11 Paragraph 75.

12 The references to "*professional person*" echo Lord Goff in *Henderson*, who thought that there could be a duty of care where a "*special skill*" was being exercised and relied on (at pp. 178 – 181).

13 See paragraph [76] of *Bellefield Computer Services v E Turner & Sons Ltd.* [2002] EWCA Civ 1823: "*A carpenter's choice of a particular nail or screw is in a sense a design choice …*".

14 J. O'Sullivan at [2011] 70 CLJ 291, 293.

15 Using Lord Goff's language, it is, presumably, the case that a builder is not thought to exercise a "*special skill*", whereas an architect is.

16 Perhaps a better approach still would be to deny the possibility of concurrent liability in tort and contract. It is notable that concurrent liability in contract and unjust enrichment is much more restricted: *The Trident Beauty* [1994] 1 WLR 161.

17 [1988] QB 758.

18 Pages 781 – 782.

19 [2014] EWHC 2016 (TCC).

20 *Architype Projects Ltd. v Dewhurst McFarlane & Partners* [2004] PNLR 38.

21 Though this was most unlikely after *Ove Arup*, where a similar argument was rejected, albeit the emphasis in that decision was on the fact the intricate contractual regime excluded a duty.

22 (2001) 17 Const. LJ 430.

23 Paragraph 53.

24 Note that the Court did not, however, finally determine the duty question (paragraph 59). Also cf. *Pacific Associates v Baxter* [1990] 1 QB 993 and *Galliford Try v Infrastructure Ltd.* [2008] EWHC 15 (TCC).

25 (1980) 14 BLR 1.

26 [1983] 2 AC 520.

27 For an excellent academic discussion about suing in tort where there is no contract claim, see J. O'Sullivan in (2007) 23 PN 165.

Back to *Burgess*

Where does this leave *Burgess*? Is it right to say that, because there was no contract, tort can freely impose obligations without concerning itself about the parties' autonomy?

No, in my view. That would be too simplistic a line to take. Where parties have failed to reach a consensus about their obligations, there might (depending on the facts) be something unpalatable about the idea of tort imposing wide ranging duties nonetheless. A compelling reason against finding a duty in *Burgess* was that there was no agreement capable of giving rise to a contract, and no intention to create legal relations.[28] At least sometimes, a lack of agreement must be a reason for finding no responsibility was assumed. Otherwise, a claimant may find itself with a windfall, having the benefit of various tortious obligations that it would never have been able to obtain contractually. Great care needs to be taken to ensure that the law of tort does not end up undermining what the parties agreed (or not, as the case may be).

Robert Scrivener, 4 Pump Court

28 Also relevant is the fact the defendant was performing services gratuitously, which was thought important in *Thornbridge Ltd. v Barclays Bank PLC* [2015] EWHC 3430 (QB), paragraphs 63 and 96(i).

Grove Developments Limited v Balfour Beatty Regional Construction Limited [2016] EWHC 168 (TCC)

The HGCRA 1996 requires that every construction contract should incorporate certain core provisions relating to adjudication and payment – in the absence of such provisions, the fall-back terms of the Scheme for Construction Contracts are implied into the contract. These provisions of the Act were intended to '*provide a framework for fairer contractual arrangements and better working relationships in the construction industry*'.[1] However, as is the case with any statutory implied term, they serve as an exception to the general principle that '*parties to a contract are free to determine for themselves what primary obligations they will accept*'.[2] In the recent TCC decision of *Grove Developments*, the proper balance between statutory implied terms and terms agreed by the parties was at issue, alongside some classic questions of interpretation regarding the objective intention of the parties themselves.

Stuart-Smith J was asked to determine whether a contractor was entitled to make an application for an interim payment in circumstances where the contract terms only countenanced interim payments for a limited period of the total duration of the works, and where the relevant application had been made after that more limited period had ended.

Grove Developments ('GDL') employed Balfour Beatty Regional Construction ('BB') to design and construct a hotel and apartment complex. The contract was a JCT Design and Build Contract 2011 with bespoke amendments. It provided for works to begin in July 2013, and for a completion date of 22nd July 2015.

The parties agreed that interim payments under 'Alternative A' of the JCT form would apply. Alternative A provides for stage payments of fixed amounts to be made on the completion of defined elements of works under the contract. In their contract, the parties did not agree what the stages would be, recording instead that they would be agreed within two weeks of the contract's entry into force. However, the parties did not come to the anticipated agreement on stage payments. Instead, they agreed a variation to their contract in the form of an agreed schedule setting out periodic payments numbered 1-23 based on valuations at particular dates between September 2013 and July 2015. The agreed schedule specified that payment would be made 30 days from the valuation date.

The works were not completed by July 2015. In around May 2015, the parties had entered into correspondence concerning the possibility of future payments after interim payment 23 under the agreed schedule. BB sent a proposed schedule of further payments to GDL which was substantially in the same form as the agreed Schedule, save that it provided for payment 28 days from the valuation date. GDL responded with a Schedule, which was materially the same as BB's proposal, except that it provided for payment 28 days from the due date.

In August 2015, BB issued its 24th application for payment ('IA24'). GDL issued a payment notice and a pay less notice in respect of that application, both of which were drafted on the basis that BB was entitled to payment 28 days from the due date. GDL paid the sum set out in its pay less notice. Two weeks later it disputed BB's entitlement to payment under IA24.

Compliance with the HGCRA 1996

A central issue in the case was whether the agreed schedule of payments complied with the provisions of s.109 of the HGCRA 1996. BB relied upon the fact that s.109(1) entitled it to interim payments for '*any work done*'. In BB's submission that provision extended its entitlement to interim payment for all its works; as the agreed interim payment schedule only covered some of the works that had been carried out, it was not compliant with s.109 of the HGCRA.

The judge first considered what the consequences of BB's argument would be if it were right. He came to the

1 Viscount Ullswater, *Hansard* vol 569 cc1005-31

2 Photo Production Limited v Securicor Transport Limited [1980] A.C. 827 at 848.

conclusion – taking into account the Scots case of *Hills Electrical & Mechanical v Dawn Construction Ltd*,[3] and the TCC decision in *Yuanda (UK) Co Ltd v WW Gear Construction*[4] – that if a construction contract does not meet the requirements of ss.109 or 110 of the HGCRA, it does not automatically import all the terms of the Scheme for Construction Contracts. Only those provisions necessary to make up for the inadequacy in the construction contract will be implied.

However, that finding did not apply in *Grove* because the judge rejected the suggestion that interim payments had to cover the entire period of works:

i. to read the HGCRA in that way would '*be a draconian restriction on the freedom of commercial parties to contract on terms of their choosing*';

ii. s.109(2) makes clear that the parties are given substantial liberty in agreeing the terms of their stage or interim payment regime;

iii. even on BB's reading of the HGCRA, whereas the interim payments would have to apply to all the works, the parties would still be free to adopt any amount or any interval for those payments. On that basis, the interim payments could still have been nil, front-loaded in advance of the work done, or made very late on.

Stuart-Smith J also endorsed the view of the editors of *Keating on Construction Contracts* that a contract prescribing one periodic payment of even an insignificant amount would meet the requirements of s.109.[5]

The terms of the contract

Stuart-Smith J also considered two further arguments based on the terms of the contract themselves that:

i. there was an implied term of the contract which entitled BB to interim payments after valuation 23;

ii. the parties' subsequent discussions regarding payments after valuation 23 amounted to a variation providing for further payments.

Stuart-Smith J's approach took into account the recent decision of the Supreme Court in *Arnold v Britton*.[6] He noted that business common sense will only be used to interpret a contract with more than one meaning, and that a court should not strain to find ambiguity in a clause where none exists. In any event, Stuart-Smith J expressed caution about the validity of business common sense arguments, because '*what appears to be business common sense may depend upon the standpoint from which the question is asked.*'

With regard to the possible existence of an implied term, Stuart-Smith J first rejected that there was any ambiguity in the provisions of the contract. He found that the agreed schedule listing interim payments 1-23 evinced the parties' clear intention that those payments were intended to be exhaustive, and no further entitlement to payment could be implied.

That notwithstanding, he went on to consider the business common sense of such an interpretation. The judge observed that limiting interim payments to the planned duration of the contract served the commercial aim of putting pressure on BB to finish its work on time. He was not persuaded by the suggestion that it did not make business common sense for that financial pressure to be placed on BB irrespective of whether any delays in the works were its fault. Although BB might wish to have protected its position from such an outcome, he did not consider that to affect the underlying commercial reality of the situation.

Moreover, the judge did not find that the parties made a subsequent variation to their interim payment arrangements by way of their proposed schedules in and around May 2015. He held that the terms on which the interim payments were to be made were crucial to the formation of any agreement. As the parties could not expressly agree as to whether payment should be made 28 days from the valuation date or 28 days from the due date, no variation had arisen.

Stuart-Smith J's judgment provides helpful clarity where the partial application of the Scheme for Construction Contracts to non-compliant construction contracts is concerned. There is also little doubt that his application of *Arnold v Britton* will be of relevance to many other construction disputes in future. Perhaps most significantly, *Grove Developments v Balfour Beatty* is a case which emphasises the parties' freedom of contract in the context of statutory implied terms. Stuart-Smith J's decision makes clear that a *de minimis* interim payment mechanism will be adequate to satisfy s.109 of the HGCRA. Whether that approach will always satisfy the statutory purpose of facilitating cash-flow in construction contracts is open to question.

It should be noted that Balfour Beatty Regional Construction has been granted leave to appeal Stuart-Smith J's decision to the Court of Appeal, in a hearing scheduled for July 2016.

Nicholas Maciolek, Atkin Chambers

3 [2004] SLT.

4 [2010] BLR 435.

5 *Keating on Construction Contracts* 9th ed at 18-057. It should be noted that the Act creates an entitlement to '*interim payments*' in the plural.

6 [2015] AC 1619.

Cavendish Square Holding BV v Talal El Makdessi and Parking Eye Ltd v Beavis [2015] UKSC 67

The doctrine of penalties is well known (even if not always well understood), ever since Lord Dunedin's authoritative exposition in *Dunlop Pneumatic Tyre v New Garage and Motor Co Ltd*,[1] which has effectively cemented the *'genuine pre-estimate of loss'* test with *'the status of a quasi-statutory code'*.[2]

In the construction context, the traditional dichotomy between a liquidated damages clause and a penalty clause depended on whether the sum stipulated by an employer is designed to compensate him for foreseeable losses caused by late completion. However, as the editors of *Hudson's Building and Engineering Contracts* noted, *'there are no recent reported cases where the amount of liquidated damages agreed in a construction contract have been held to be penal'*.[3]

Many would no doubt recall what Diplock LJ famously confessed exactly five decades ago: *'I make no attempt, where so many others have failed, to rationalise this common law rule'*.[4] Five decades later, in a joined appeal of two starkly different cases, the Supreme Court has decided to make such an attempt – in five separate judgments running to 123 pages.

The decisions in the Court of Appeal

Cavendish Square Holding BV v Talal El Makdessi

The first appeal concerned a share sale agreement which restricted competition by the seller, Mr Makdessi, of the shares sold to the buyer, Cavendish Square. Mr Makdessi was in breach of his fiduciary duties, and under clause 5.1, he was disentitled from receiving interim/final payments for the shares. Under clause 5.6, Cavendish Square had a further *'put option'* to purchase all of Mr Makdessi's shares. It was argued that those clauses are penal.

The Court of Appeal noted a *'new approach'* in recent authorities.[5] Christopher Clarke LJ acknowledged that the court is adopting *'the broader test of whether the clause was extravagant and unconscionable with a predominant function of deterrence; and robustly declining to do so in circumstances where there was a commercial justification for the clause'*.[6] His Lordship nonetheless applied the *Dunlop* test, holding that the clauses are not genuine pre-estimates of loss,[7] and then went on to conclude that the clause acts as a deterrent and cannot be saved by its commercial justification.[8]

Parking Eye Ltd v Beavis

The second appeal involved a very different but much more relatable type of clause – a parking charge of £85 (reducible to £50 on prompt payment) imposed on motorists for overstaying the maximum free parking period. Mr Beavis refused to pay the charge and argued that it was a penalty clause. An unassuming small claim in the county court thus transfigured into a valiant crusade on behalf of all motorists on the Clapham Omnibus, making its way to the Court of Appeal.

Moore-Bick LJ observed that a clause is not penal *'if it can be justified commercially and if its predominant purpose is not to deter breach'*.[9] His Lordship held that the charge was not penal because of a *'combination of factors, social and commercial'*, even though its principal purpose was deterrent.[10] In reaching this conclusion, strong support was drawn from the Protection of Freedoms Act 2012.[11]

Sir Timothy Lloyd also agreed that in a **non-commercial contract,** an intention to deter is *'not sufficient in itself to invalidate the term'*, but stressed that the penalty rule still applies *'[i]f the charge were grossly disproportionate'*.[12] Thus, it is eminently clear that the decision was based on the particular facts and nature of the charge.

The Supreme Court's new test

The Supreme Court prefaced its judgment with the observation that the *'test for distinguishing penal from other principles is unclear'*.[13] After a comprehensive discourse on the case law,[14] the Supreme Court categorically refused to abrogate the doctrine, but decided instead to reformulate the test.

Lords Neuberger and Sumption concluded that the doctrine has become a *'prisoner of artificial categorisation'* based on an *'unsatisfactory distinction'* between a penalty and a genuine pre-estimate of loss. Their Lordships held that a deterrent is not *'inherently penal'*, and the *'true test is whether the impugned provision is a secondary obligation which imposes* ***a detriment on the contract-breaker out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation'***.[15] The other Justices reached similar conclusions.[16]

1 [1915] AC 67 at 86-88.

2 [2015] UKSC 67 *per* Lords Neuberger and Sumption at [22].

3 (13th edn, 2015) at [6-045].

4 *Robophone Facilities Ltd v Blank* [1966] 1 WLR 1428 at 1446-47.

5 E.g. *Lordsvale Finance plc v Bank of Zambia* [1996] QB 752 *per* Colman J at 763-64; *Cine Bes Filmcilik ve Yapimill v United International Pictures* [2003] EWCA Civ 1669 *per* Mance LJ at [15]; *Murray v Leisureplay* [2005] EWCA Civ 963 *per* Arden LJ at [46]-[54].

6 [2013] EWCA Civ 1539 at [104].

7 At [105]-[117].

8 At [118]-[122].

9 [2015] EWCA Civ 402 at [21].

10 At [27].

11 At [28].

12 At [51].

13 [2015] UKSC 67 *per* Lords Neuberger and Sumption at [3].

14 At [3]-[28]; also *per* Lord Mance at [131]-[151], and *per* Lord Hodge at [219]-[254].

15 At [31]-[32].

16 *Per* Lord Mance at [152], *per* Lord Hodge at [255], and *per* Lord Toulson at [293].

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In so doing, the Supreme Court has gone much further than the Court of Appeal by (1) generally supplanting the *Dunlop* tests, and (2) allowing deterrents in commercial contracts insofar as not extravagant or unconscionable.

Applying the new test, the Justices (Lord Toulson dissenting on *ParkingEye*) held that the clauses in *Makdessi* and *ParkingEye* are not penal. In *Makdessi*, Lords Neuberger and Sumption held that the clauses protected a *'legitimate interest in the observance of the restrictive covenants'*,[1] and they are *'part of a carefully constructed contract which had been the subject of detailed negotiations over many months between two sophisticated commercial parties'*.[2]

As for *ParkingEye*, it was held that the parking charge, although obviously deterrent in nature, pursued the legitimate interests of managing *'the efficient use of parking space'* and providing *'an income stream'*.[3] Unlike in the Court of Appeal, no reliance was placed on the statute.[4] The charge was simply held to be reasonable and prominently displayed.[5]

Practical implications

The new test is largely premised on the view that the doctrine of penalties is *'an interference with freedom of contract'*,[6] and where the parties' bargaining positions are equal, *'the strong initial presumption must be that the parties themselves are the best judges of what is legitimate'*.[7] **Four observations** can be made:

(1) The reasoning behind *ParkingEye* should be read within its non-commercial context. No assumption should be made that the Court would readily accept arguments based on open-ended, non-financial interests in commercial contracts, although this may be plausible in PFI contracts and other public infrastructure projects. On any view, careful thought should be given to the proportionality of the deterrent.

(2) Indeed, although the test is now one of *'legitimate interest'*, Lords Neuberger and Sumption stressed that*'[i]n the case of a straightforward damages clause, that interest will rarely extend beyond compensation for the breach, and we therefore expect that Lord Dunedin's four tests would usually be perfectly adequate to determine its validity'*.[8] In the construction context, an attempt to estimate the financial losses due to late completion is still the surest way of ensuring the enforceability of a liquidated damages clause.

(3) As the Supreme Court's conclusion on *Makdessi* demonstrates, much weight is given to the parties' bargaining positions. Given that contractors are often in a weaker bargaining position when it comes to liquidated damages (which are normally set by employers), employers should not think of the new test as a *carte blanche* or as an invitation to inflate the amount of liquidated damages.

(4) Finally, it is worth noting the difficulties with the conclusions in *ParkingEye*, as Lord Toulson was not convinced by the reasonableness and fairness of the charge.[9] The limits of the doctrine of penalties are by no means free from doubt, and in the construction industry, it is arguable that *'in these days when so often one party cannot satisfy his contractual hunger à la carte but only at the table d'hôte of a standard printed contract, it has certainly not outlived its usefulness'*.[10]

Lord Denning MR once memorably described the *'heyday of the freedom of contract'* as the *'bleak winter of our law of contract'*, when the *'big concern said, "Take it or leave it." The little man had no option but to take it'*.[11] It remains to be seen how the court would apply the new test, but it is hoped that a balance would be struck between freedom of contract and protection against extravagant penalties.

Mathias Cheung, Pupil Barrister

1 At [75].
2 At [82]; also *per* Lord Mance at [181]-[185], and *per* Lord Hodge at [271]-[278]
3 At [98]-[99].
4 *Per* Lord Mance at [191]-[192].
5 At [100]; also *per* Lord Mance at [197]-[198], and *per* Lord Hodge at [286]-[287].
6 *Per* Lords Neuberger and Sumption at [33].
7 At [35].
8 At [32]; also *per* Lord Hodge at [255].
9 At [312]-[314].
10 *Robophone Facilities Ltd v Blank* [1966] 1 WLR 1428 *per* Diplock LJ at 1447.
11 *George Mitchell (Chesterhall) Ltd v Finney Lock Seeds Ltd* [1983] QB 384 at 296-97.

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