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Penalties in Construction Law following the High Court's Decision in *Andrews v ANZ*

Why is there such a fuss about Andrews v ANZ?

1. The decision of *Andrews v Australia and New Zealand Banking Group Ltd*[1] handed down by the High Court of Australia in September 2012 has resulted in a lot of ink spilled on its impact on construction contracts. The controversy has resulted from the formulation set out in paragraph 10 of that decision, which is as follows:

> *In general terms, a stipulation prima facie imposes a penalty on a party ("the first party") if, as a matter of substance, it is collateral (or accessory) to a primary stipulation in favour of a second party and this collateral stipulation, upon the failure of the primary stipulation, imposes upon the first party additional detriment, the penalty, to the benefit of the second party. In that sense, the collateral or accessory stipulation is described as being in the nature of a security for and in terrorem of the satisfaction of the primary stipulation. If compensation can be made to the second party for the prejudice suffered by failure of the primary stipulation, the collateral stipulation and the penalty are enforced only to the extent of that compensation. The first party is relieved to that degree from liability to satisfy the collateral stipulation.*

2. Further, in respect of the type of stipulations contemplated, the High Court stated the following in paragraph 12:

> *It should be noted that the primary stipulation may be the occurrence or non-occurrence of an event which need not be the payment of money. Further, the penalty imposed upon the first party upon failure of the primary stipulation need not be a requirement to pay to the second party a sum of money.*

3. It has been suggested that this decision could cause many time-bars and other like terms to become unenforceable because they appear to fit within this general principle.[2] That is, a time-bar usually contains a requirement to give notice of a claim (said to be the primary stipulation); and usually provides for the loss of entitlement to claim if the notice is not

[1] (2012) 290 ALR 595 (‘*Andrews’*).
[2] Philip Davenport, *‘Andrews v ANZ and Penalty Clauses’* (2012) 147 ACLN 32, 35; Patrick Easton ‘*Penalties percolating through the construction industry: Andrews v Australia and New Zealand Banking Group Ltd’* (2013) 29 BCL 233, 242 to 244.

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given (said to be the collateral stipulation and additional detriment).[3] Phillip Davenport argues[4] that a time-bar is penal because it 'would result in the forfeiture of an entitlement to payment of the same amount whether the delay is one day or one month or any other period'. This view has not received universal support.[5]

4. It has also been suggested that a clause permitting a head contractor to withhold final payment, retention or security until the contractor does something like provide a deed of release or give evidence of payment to its subcontractors, is penal.[6] That is, the primary stipulation is the provision of a deed of release or evidence of payment, and the collateral stipulation the withholding.
5. However, whilst the general formula set out by *Andrews* is compelling in its breadth, the application of the penalty doctrine to construction contracts is best considered in light of the history of the penalty doctrine and the various other factors applied in determining whether a clause is or is not penal. It should also be noted that the High Court appears to have qualified the formula by using the phrases 'in general terms', and 'prima facie', both of which suggest further considerations apply.
6. For the purpose of this paper, it is assumed that traditional liquidated damages clauses are capable of being characterized as penalties. The remainder of the paper will focus on clauses not traditionally considered to be penal.

A potted history of the penalty doctrine

7. It is uncontroversial that the jurisdiction to relieve against penalties originated with the bond. The bond is an instrument under seal, usually a deed poll, in which the obligor is bound to the obligee. The obligor agrees to satisfy a condition in the bond (e.g. not trading in a particular area for a particular time, or not allowing its employees to go on strike) and failure to comply with the condition results in a collateral stipulation, usually the payment of money (but not always).
8. The term 'condition' is used in a different sense to that in contract law – in a bond it is the act to be performed or the event to occur, the failure of which gives rise to the stipulation. By way of contrast, the term 'condition' used in contract law means an important, vital or

[3] Davenport, above n 1, 35.
[4] Davenport above n 1, 34.
[5] John Bond*, 'Contrary to What You Might Have Heard, a Properly Drafted Contractual Time Bar Will Not Attract the Penalty Doctrine'*, The Arbitrator & Mediator June 2013, 69.
[6] Davenport, above n 1, 35, 36.

material promise the breach of which will repudiate the contract. This is an important distinction, which is fundamental to the High Court's decision in *Andrews*.

9. A practice arose out of Roman law and which continued in equity where the amount stated in a stipulation and named as a penalty might be reduced if found to be excessive. While the obligee sued the obligor for the whole of the bond amount as a debt action, equity looked to what was involved in satisfaction of the condition for which the bond was security. Equity continued this practice of relieving against penal bonds, but also extended the practice to relieving against penal provisions in simple contracts. However, equity would not relieve against the stipulation unless the failure of the condition was compensable.
10. Fast-tracking to 1914, the House of Lords in *Dunlop Pneumatic Tyre Company Ltd v New Garage and Motor Company Ltd*[7] was faced with an action by Dunlop against New Garage. The action arose from an agreement between Dunlop and New Garage in which New Garage agreed to sell Dunlop's tyres for a price not less than the current list price specified by Dunlop. There was a term of the agreement that required New Garage to pay 5l for each and every tyre sold in breach of the agreement. New Garage sold tyres for under the list price, Dunlop sued New Garage for the stipulated sum per tyre, and New Garage alleged that this was a penalty. The Master found that there was no penalty, the Court of Appeal held that there was a penalty, and the House of Lords held that there was no penalty.
11. In the course of making his finding, Lord Dunedin set out five succinct propositions arising from the cases on penalties, as follows (citations omitted):

> *1. Though the parties to a contract who use the words "penalty" or "liquidated damages" may prima facie be supposed to mean what they say, yet the expression used is not conclusive. The Court must find out whether the payment stipulated is in truth a penalty or liquidated damages. This doctrine may be said to be found passim in nearly every case.*
>
> *2. The essence of a penalty is a payment of money stipulated as in terrorem of the offending party; the essence of liquidated damages is a genuine covenanted pre-estimate of damage*
>
> *3. The question whether a sum stipulated is penalty or liquidated damages is a question of construction to be decided upon the terms and inherent circumstances of each particular contract, judged of as at the time of the making of the contract, not as at the time of the breach.*

[7] [1915] AC 79 ('*Dunlop*').

4. To assist this task of construction various tests have been suggested, which if applicable to the case under consideration may prove helpful, or even conclusive. Such are:

(a) It will be held to be penalty if the sum stipulated for is extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from the breach.

(b) It will be held to be a penalty if the breach consists only in not paying a sum of money, and the sum stipulated is a sum greater than the sum which ought to have been paid…

(c) There is a presumption (but no more) that it is penalty when "a single lump sum is made payable by way of compensation, on the occurrence of one or more or all of several events, some of which may occasion serious and others but trifling damage"

On the other hand:

(d) It is no obstacle to the sum stipulated being a genuine pre-estimate of damage, that the consequences of the breach are such as to make precise pre-estimation almost an impossibility. On the contrary, that is just the situation when it is probable that pre-estimated damage was the true bargain between the parties.

12. What is apparent from Lord Dunedin's propositions is that apart from the proposition in paragraph 4(c), the penal consequences all seem to flow from a breach of contract – however, as the High Court notes in *Andrews*, Dunlop doesn't focus on the anterior stage of analysis, namely identification of those criteria by which the penalty doctrine is engaged.
13. The matter of *ECGD v Universal Oil Products Co and Ors*[8] contemplated the anterior stage that was not considered by the House of Lords in *Dunlop*. There, a party was required to indemnify a guarantor, a government body, in respect of financial obligations under a construction contract. The guarantor's liability arose and the indemnifier was called on to indemnify the guarantor. The indemnifier alleged that the requirement to indemnify the guarantor was a penalty.
14. The main judgment was delivered by Lord Roskill, who agreed with the statements in the Court of Appeal below that the relevant clause was not a penalty clause because it provided for payment of money on the happening of a specified event other than a breach of a contractual duty owed by the contemplated payer to the contemplated payee.[9] Lord Roskill said that it is not and never has been for the courts to relieve a party from the

[8] [1983] 2 All ER 205 (*'ECGD'*)
[9] *ECGD*, 223.

consequences of what may in the event prove to be an onerous or possibly even a commercially imprudent bargain.[10]

15. Thus from these two important cases it appeared that the jurisdiction to relieve against penalties was restricted to breach of contract only. This position should be contrasted to the historical jurisdiction in equity to relieve against penal bonds, where the failure of the condition in the bond is not a breach of contract, but is the happening of an event that triggers liability for the stipulation. Hence, *ECGD* appeared to place a defined limit on the circumstances in which the Court could intervene to strike down a penalty.
16. *AMEV-UDC Finance Ltd v Austin & Anor*[11] concerned a hire purchase agreement with a term allowing the owner of the equipment to terminate the agreement on the happening of specified events and recover the whole of the balance of the rent without rebate, repossess and sell the good and recover the difference, if any, between the residual value of the goods and the proceeds of sale. There, the owner terminated the agreement on non-payment by the hirer and issued proceedings for its entitlement under the agreement pursuant to the above term.
17. Mason and Wilson JJ in *AMEV* acknowledged the authority of *ECGD* to the effect that the doctrine of penalties has no application to a stipulation which provides for the payment of an agreed sum on the happening of a specified event other than a breach of contract, but noted that this proposition had difficulties where there is a contract which contains an exercise of an option to terminate conditional on the happening of any one of a series of events, some of which are breaches of contract and others which are not.[12]
18. Their Honours also traced the history of equity relieving against penalties, including penal bonds, noting as follows:[13]

> *I) equity would only relieve where compensation could be made for the actual damage suffered by the party seeking to recover the penalty; (2) the actual damage suffered by the party was assessed in an action at common law, such as an action of covenant, or upon a special issue quantum damnificatus which could be joined in an action on the case: Simpson, Joe. cit., fn. 11, p. 418; (3) the expression "actual damage" seems to have been used in contradistinction to "agreed sum" or "liquidated" or "stipulated" damages, not by way of opposition to damage which was recoverable at law; (4) there seems to have been no instance of equity awarding compensation over and above the amount awarded as common law*

[10] *ECGD*, 224.
[11] (1986) 162 CLR 170 ('AMEV').
[12] *AMEV*, 184.
[13] *AMEV*, 190.

damages, other than cases in which equity would not relieve against the penalty; and (5) relief was granted, in the case of penal bonds, where there was no express contractual promise to perform the condition (see Hardy v. Martin), though it seems such a promise could in many cases readily be implied.

(emphasis added)

19. There, the High Court regarded the clause as a penalty because liability to pay damage flowed not from the hirer's breach of contract but from the owner's act in exercising a contractual right to terminate for non-fundamental breach.[14]
20. In *Integral Home Loans Pty Ltd & Anor v Interstar Wholesale Finance Pty Ltd & Anor*[15] Brereton J looked at the history of the jurisdiction to relieve against penalties and held that the doctrine is not restricted to breach of contract, contrary to *ECGD*. In that matter Interstar was a finance company which lent money, and Integral was a mortgage originator, which introduced lenders to Interstar. Once a loan was approved, Integral would manage the loan on an ongoing basis. The relationship between the parties was governed by an agreement that provided for an originator's fee for Integral originating and managing the loans. The originator's fee was based on a percentage of the outstanding loan balance from time to time.
21. Interstar terminated the agreement alleging that Integral engaged in deceptive activity. As a result of the termination, and under the terms of the termination clause, Integral ceased being entitled to the originator's fee, also described as a 'trailing commission'.
22. Brereton J held that the clause preventing the recovery of the originator's fee was void as a penalty because:
    a. the originator's fee was earned at the time of termination;[16]
    b. the doctrine of penalties applies not only to a stipulation requiring the payment of money, but it extends to the transfer of property or the withholding or retention of money;[17] and
    c. the law of penalties was not restricted to breaches of contract, but extended to the occurrence of an event;[18]

[14] *AMEV*, 191.
[15] [2007] NSWSC 406 ('*Integral*')
[16] *Integral*, [16], [17].
[17] *Integral*, [12].
[18] *Integral,* [72] - [76].

23. In making the third finding, Brereton J in *Integral* regarded the principles in *Dunlop* referring to breach as being the trigger for the doctrine of penalties as being the 'standard application' of the doctrine, and not complete or universal.
24. The New South Wales Court of Appeal in *Interstar Wholesale Finance Pty Limited v Integral Home Loans Pty Limited*[19] disagreed with the characterization of the fee by Brereton J and held that the right to the originator's fee had not accrued, particularly with respect to the 'management' part of the fee. Because the originator's fee was not earned, 'the right to receive the fees did not survive unaffected by the termination'.[20]
25. The Court then went on to consider, as an alternative proposition in the event that its characterization of the originator's fee was wrong, whether the term could amount to a penalty.[21] The New South Wales Court of Appeal held that the modern rule against penalties was a rule of law and not equity.[22] Further, the Court held that the term could not be characterized as penal because the law of penalties was restricted to circumstances of breach of contract.[23] The High Court in *Andrews* disagreed with these conclusions.

What was Andrews v ANZ all about?

26. *Andrews* was a class action brought by around 30,000 banking customers of the ANZ Bank. The customers alleged that the fees they had been charged were penal in nature and therefore unenforceable, including:
    a. 'honour fees' and 'dishonour fees', which were charged by the bank to a customer where the customer authorized a payment in circumstances where the customer had insufficient clear funds: in the case of 'honour fees', the bank honoured the client's instruction; and in the case of 'dishonour fees', the bank declined to honour the client's instruction;
    b. 'overlimit fees', which were charged by the bank to a customer where the customer exceeded a credit limit on a credit card account; and
    c. 'late payment fees', which were charged by the bank to a customer where the customer had not made required payments on time.
27. Gordon J, the primary Judge in *Andrews*, noting that the Court was bound by the authority of the New South Wales Court of Appeal in *Interstar*, held that only the late

[19] [2008] NSWCA 310 ('*Interstar'*)
[20] *Interstar* [84].
[21] *Interstar,* [95].
[22] *Interstar*, [99].
[23] *Interstar*, [106].

payment fees, being the only fees that were payable on breach, were capable of being characterized as penalties.[24]

28. The matter was removed from the Full Court of the Federal Court of Australia to the High Court on a question of the nature of the jurisdiction to relieve against penalties and the question whether relief is available only after the penalty is imposed upon a breach of contract.
29. The High Court traced the history of the doctrine to relieve against penalties and disagreed with the findings of the New South Wales Court of Appeal in *Interstar*, and thus disagreed with the decision of Gordon J at first instance. First, the High Court held that the doctrine to relieve against penalties is rooted in equity and the Court of Appeal was wrong to say that the penalty doctrine is a rule of law and not equity. Further, the High Court held that the penalty doctrine was not just restricted to circumstances of breach of contract or where the obligor had the responsibility or obligation to avoid the occurrence of events leading to the stipulation.

Time-bars

30. The courts consider time-bars to have important purposes, including:[25]
    a. to enable a claim to be investigated promptly and perhaps before any work comprised in it is rebuilt or built over; and
    b. to enable the recipient of the notice ('Recipient'), usually the principal or head contractor, to monitor its exposure to the claimant providing the notice ('Claimant'), and if the Recipient is a head contractor, to enable it to assess its own position with respect to the principal.
31. An example of a typical EOT (extension of time) time-bar is seen in the matter of *City Inn Limited v Shepherd Construction Limited*:[26]

> *13.8.1. Where, in the opinion of the contractor, any instruction, or other item which, in the opinion of the contractor, constitutes an instruction issued by the architect, will require an adjustment to the contract sum and/or delay the completion date, the contractor shall not execute such instruction (subject to clause 13.8.4* [dispensation with requirement to give notice*]) unless he shall have first submitted to the architect, in writing, within ten working*

[24] *Andrews v Australian and New Zealand Banking Group Limited* [2011] FCA 1376 (Unreported, Gordon J, 5 December 2011).
[25] *John Goss Projects v Leighton Contractors and Anor* [2006] NSWSC 798 (Unreported, McDougall J, 14 August 2006), [80] ('*John Goss'*).
[26] (2003) BLR 468, [11] ('*City Inn'*).

days (or within such other period as may be agreed between the contractor and the architect of receipt of the instruction, details of [estimates of the adjustment, additional resources, length of extension of time, and loss or expense].

13.8.5 *If the contactor fails to comply with any one or more of the provisions of clause 13.8.1, where the architect has not dispensed with such compliance under clause 13.8.4, the contractor shall not be entitled to any extension of time under clause 25.3.*

(emphasis added)

32. Other examples of time-bars include:
    a. FIDIC 1st Ed. 1999, clause 20 (EOT);
    b. AS4000-1997 clause 34.3 (EOT);
    c. AS4000-1997 clause 36 (variations);
    d. NPWC Edition 3 'residual' clause 47 (claims):
    e. AS2124-1992 clause 35.5 (EOT);
    f. AS2124-1992, clause 40.2 (variations); and
    g. The bespoke time-bar in *John Goss* (variations).
33. The failure to give notice pursuant to a time-bar that otherwise enables a Claimant to claim an extension of time will usually cause the Claimant to become exposed to liquidated damages for the delay caused by the event that ought to have been the subject of that notice. Although a consideration of the 'prevention principle' is beyond the scope of this paper, it is sufficient to say that the general position of Australian courts is that the failure of a Claimant to issue a notice claiming an extension of time in respect of the Recipient's preventing conduct is usually fatal to the Claimant's argument that time is set 'at large' by that preventing conduct.[27] Because of this, the failure to issue a notice could have a catastrophic financial impact upon a Claimant.
34. The question of whether there is an entitlement to be forfeited is an issue considered by Brereton J and the New South Wales Court of Appeal in *Integral* and *Interstar*, respectively. It was also considered by the Court of Session in *City Inn*.
35. In *City Inn*, the contractor claimed to have been delayed and sought an extension of time. The architect allowed four weeks, and the question of entitlement was referred to an adjudicator who decided that the contractor was entitled to an additional five weeks. The principal claimed that the contractor did not comply with the notice provisions in clause

[27] *Turner Corporation Ltd v Austotel Pty Ltd* (1994) 13 BCL 378 ('*Turner v Austotel'*); and *Turner Corporation Ltd v Co-ordinated Industries Pty Ltd* (1995) 11 BCL 202.

13.8.1 and therefore it was barred from any entitlement as a result of clause 13.8.5. The contractor argued that clause 13.8.5 was a penalty because it caused the imposition of liquidated damages on failure of the contractor to give notice.

36. The Court of Session held that the failure to comply with the notice provisions did not amount to a breach of contract, but that the clause gave the contractor an option to take certain action if he seeks the protection of an extension of time in the circumstances in which the clause applies[28] Further, the requirement in clause 13.8 was a condition precedent to him gaining an entitlement to claim an extension of time, and that the contractor was barred from a claim.[29]

Withholding

37. Brereton J in *Integral* made it clear that the penalty doctrine applies to retention or withholding of a payment that the party would otherwise be entitled to receive.[30] For instance, AS2124-1992 cl 43 and AS4000-1997 cl 38 entitle the principal to withhold payment to a contractor until the contractor provides a statutory declaration or documentary evidence that the contractor has paid its subcontractors. There, the primary stipulation is the provision of evidence of payment of the subcontractors, and the collateral stipulation is the withholding of payment otherwise payable.
38. In *Gilbert-Ash (Northern) Ltd v Modern Engineering (Bristol) Ltd*[31] a construction contract had a clause for withholding which provided that:

    [3] If the Sub-contractor fails to comply with any of the conditions of this Sub-contract, the [main] Contractor reserves the right to suspend or withhold payment of any monies due or becoming due to the Sub-contract[or].

39. The House of Lords held that clause 3 would entitle the main contractors to withhold sums far in excess of any fair estimate of the value of its claims. Viscount Dilhorne said that read literally the sentence provides for the imposition of a penalty that may be wholly disproportionate to the damage suffered by the contractor.[32] Lord Salmon said that the clause would enable the contractors to suspend or withhold payment of very large sums of money due by them to the subcontractors in the event of some minor breach of contract

[28] *City Inn*, [24].
[29] Ibid, [29].
[30] *Integral*, [10], [19], [71].
[31] [1974] AC 689 (‘*Gilbert Ash’*).
[32] *Gilbert Ash*, 210.

causing only trivial damage in no way comparable to the amount owed to the subcontractors.[33]

40. *Bysouth v Shire of Blackburn and Mitcham* (No. 2)[34] also concerned a withholding clause. There, the contract between the Shire and the contractor provided for termination in the following circumstances: there was insufficient progress of the works; there was failure to rectify bad work within 7 days; there was a willful breach of the contract; or there was Sunday work performed without permission.[35] The consequences of termination included: moneys previously paid are deemed to be the full value of the work executed; the deposit and retention moneys shall remain the absolute property of the Shire; all materials, implements and plant shall remain the absolute property of the Shire.[36]
41. Irvine CJ noted that the conditions for termination could include anything from a complete failure of the contractor to carry out the most important works of the contract down to a failure of the contractor to rectify any defect, however slight, in the works or even the doing of work on a Sunday. Irvine CJ held that the consequences resulting from the exercise of the power was incommensurable with the default or loss arising, and that the clause was penal to the extent that it purported to forfeit moneys due to the contractor, and money's worth (i.e., the materials, implements and plant) to which the contractor was entitled.[37]
42. By way of contrast, Irvine CJ held that the Shire was entitled to withhold the deposit and retention moneys because the contractor was not entitled to their return as a result of the contract being determined before the conditions for their return could arise:

> *Different considerations apply to the deposit and retention money. By clause 24 these moneys are not the property of the contractor until the engineer has certified that the works have been finally and satisfactorily completed. The effect of the contract being determined under the power contained in the earlier part of clause 11 is to render the fulfillment of the condition impossible; hence there is no forfeiture of any rights of the contractor to these any more than there is a " forfeiture," by the exercise of the power to determine the contract, of the profits which the contractor would have made if he had been allowed to complete the contract.*

[33] *Gilbert Ash*, 220.
[34] [1928] VLR 562 ('*Bysouth*').
[35] *Bysouth*, 570.
[36] *Bysouth,* 584.
[37] *Bysouth*, 574 to 575.

Conditions precedent to entitlement

43. The cases referred to so far have drawn a distinction between entitlements that are accrued, and entitlements that are not accrued. Assuming the particular clause is crafted in such as way as to be a condition precedent, then there is doubt whether a stipulation for the loss of an entitlement could be regarded as penal when the conditions precedent for the entitlement have not been satisfied. In addition to the above cases there are several other Australian and English authorities that consider the effect of conditions precedent on the penalty doctrine, which find that there is no penalty where the entitlement lost is not accrued.

44. For instance:

    a. *Eshelby v Federated European Bank Limited*[38] in which a contractor unsuccessfully sued a guarantor for payment in circumstances where payment was conditioned on works being complete and on the appropriate notices being given, and the works were neither complete nor were the notices given.

    b. *The "Vainqueur Jose"*,[39] in which Mocatta J held that a clause in a contract of insurance allowing the rejection of a claim by an insurer on failure to give notice within a specified time was not a penalty.

    c. *Nutting and Ors v Baldwin and Ors*[40] in which unpaid members to a litigation funding agreement were unsuccessful in their argument that a term barring an unpaid member's entitlement to the proceeds of litigation was penal.

    d. *SCI (Sales Curve Interactive) Limited v Titus Sarl*[41] in which a licensee unsuccessfully argued that a provision denying entitlement to moneys owed was a penalty, in circumstances where the time for ascertaining the moneys owed to the licensee was not reached.

    e. *Helicopters Pty Ltd v Bankstown Airport Ltd*[42] in which a sublessee unsuccessfully argued that a provision barring the sublessee from objecting to a rent review unless all rent and outgoings owing were paid, was penal.

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[38] [1930] 1 KB 423 ('*Eshelby'*).
[39] *C.V.G Siderurgicia Del Orinoco S.A. v London Steamship Owners' Mutual Insurance Association Ltd* [1979] 1 Lloyds Rep 557.
[40] (1995) WLR 201 (*'Nutting'*)
[41] [2001] 2 All ER (Comm) 416 ('*SCI'*).
[42] [2010] NSW Conv R 56-269 ('*Helicopters v Bankstown'*).

45. Many of the above decisions above rest on two frequently seen factors:
    a. the entitlement of Claimant has not come into existence, and therefore nothing is being taken away such as to impose a penalty; and
    b. the conduct of the Claimant is such as to not merit equity's intervention.
46. The first factor is problematic where there is 'clever drafting' which conditions a significant entitlement on a minor event: for instance, see *Eshelby* and the *The "Vainqueur Jose"*. In these cases, the failure to give a notice had a dramatic effect on the rights of Claimant who ought to give the notice in accordance with the term but did not. Nevertheless, the contractual right to relief does not come into existence until that notice is given. Using the formula in *Andrews*, as the entitlement is not accrued as a result of the failure of the Claimant to do something, there is no '*additional detriment'* to the benefit of the Recipient. That is, the right to relief under the contract has not accrued, so the Claimant is losing nothing. However not all conditions precedent are safe because the entitlement has not accrued – the matter of *GTC v Richmond,*[43] discussed below, is an example of a matter where a condition precedent was regarded as a *prima facie* penalty.
47. Looking at time-bars, by failing to give the notice the Recipient could arguably be gaining a benefit in the form of works that it does not have to pay for; and liquidated damages which could have arisen from its own cause. However, these 'benefits' arise well after the clause has operated to bar the Claimant's entitlement, and, as Clerk LJ noted in *City Inn* in the context of liquidated damages*,* at that stage there is only a possibility that liquidated damages arise at a later date. Also, in each case it is unclear, unless an assessment is made at the date of breach, whether the benefit received by a Recipient could be commensurate with the detriment the Claimant incurs in the loss of its right.
48. The second factor seems to arise because the Claimant's own conduct often disentitles it from bringing the subject of the condition precedent into existence – for instance the Claimant's own disentitling conduct is expressly referred to in *Eshelby, the "Vainqueur Jose", Nutting,* and *SCI*, and it is clear in the remaining cases that the Claimant's conduct led to the loss of the entitlement.
49. Obviously it would be a harsh outcome if a Claimant could ignore the conditions that would otherwise entitle it to a benefit, and then claim that its own failure to comply with

[43] [2008] 2 Lloyds Rep 475.

those conditions amounts to the imposition of a penalty. This appears to have similar logic to that applied by Cole J in *Turner v Austotel*:[44]

> *If the Builder, having a right to claim an extension of time, fails to do so, it cannot claim that the act of prevention which would have entitled it to an extension of time for Practical Completion resulted in its inability to complete by that time. A party to a contract cannot rely upon preventing conduct of the party where it failed to exercise a contractual right which would have negated the effect of the preventing conduct.*

50. Finally, most if not all conditions precedent contain primary and secondary stipulations, the second of which is consequent upon the occurrence or non-occurrence of the first.[45] It is Mr Davenport's characterization of the secondary stipulation as collateral or accessory to the primary stipulation that is said to result in a penalty. However, if a time-bar is caught by the penalty doctrine because the secondary stipulation (barring the claim) is said to be collateral or accessory to the first, then arguably most conditions precedent would be caught also. The difficulty of reconciliation of the penalty doctrine to common terms in insurance contracts, particularly conditions precedent, is referred to in the *The "Vainqueur Jose"*, with the result that the penalty doctrine was not regarded as being applicable. In the writer's view, given the facts of *Andrews* and the history of the law of penalties and the application to conditions precedent, it is unlikely that the High Court had the consequence of the application of the penalty doctrine to conditions precedent in mind when arriving at its formula for the penalty doctrine.
51. Like time-bars, the answer to whether a withholding clause could be penal might be whether or not the withholding clause is drafted in such a way that the entitlement to receive the benefit is accrued or not. In *Gilbert-Ash*, the relevant clause allowed withholding of moneys due, whereas in *Bysouth* and *SCI*, the relevant clause allowed withholding of deposit and retention moneys which were not otherwise payable until the conditions precedent for their return were met. Of course, withholding clauses will often present a greater difficulty than time-bars because withholding clauses often operate to bar the payment of amounts otherwise due, such as AS2124-1992 cl43 and AS4000-1997 cl 38.

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[44] (1994) 13 BCL 378, 384-385.
[45] E.g., *Maynard v. Goode* (1926) 37 CLR 529; *Perri v Coolangatta Investments Pty Ltd* (1982) 149 CLR 537, 565.

Additional factors to consider

52. Because the doctrine of penalties is a doctrine in equity, unconscionability has a large role to play in the question of whether a clause is or is not penal. Mason and Wilson JJ discussed the supervisory jurisdiction of equity in *AMEV-UDC Finance Ltd v Austin*[46]:

> *[E]quity and the common law have long maintained a supervisory jurisdiction, not to rewrite contracts imprudently made, but to relieve against provisions which are so unconscionable or oppressive that their nature is penal rather than compensatory. The test to be applied in drawing that distinction is one of degree and will depend on a number of circumstances, including (1) the degree of disproportion between the stipulated sum and the loss likely to be suffered by the plaintiff, a factor relevant to the oppressiveness of the term to the defendant, and (2) the nature of the relationship between the contracting parties, a factor relevant to the unconscionability of the plaintiff's conduct in seeking to enforce the term. The courts should not, however, be too ready to find the requisite degree of disproportion lest they impinge on the parties' freedom to settle for themselves the rights and liabilities following a breach of contract.*
>
> (emphasis added)

53. Other factors that have been identified by the courts, including on the issue of unconscionability, could present an impediment to these clauses being characterized as penal. These include:
    a. whether the damage caused by the failure of the primary stipulation is susceptible of evaluation, to be determined at the date of the contract;[47]
    b. whether the detriment imposed by the collateral stipulation is extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from the breach;[48]
    c. whether the clause is commercially justifiable, provided always that its dominant purpose was not to deter breach;[49]

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[46] (1986) 162 CLR 170 ('*AMEV*'), 193-194; approved by Wilson and Toohey JJ in *Esanda Finance Corporation Ltd v Plessnig* (1989) 166 CLR 131.
[47] *Andrews*, [11].
[48] *Ringrow Pty Ltd v BP Australia Pty Ltd* (2005) 224 CLR 656, [11]; *Dunlop* [1915] AC 79, 86-87.
[49] *GTC v Richmond* [2008] 2 Lloyds Rep 475, [45]; *Lordsvale Finance plc v Bank of Zambia* [1996] QB 752, 762-4; *Bartercard Ltd v Myallhurst Pty Ltd* [2000] QCA 445 (Unreported, Davies, Thomas JJA and Ambrose J, 27 October 2000).

d. whether the clause amounts to oppression, in the sense that the exercise of the contractual power might be oppressive to the party in breach, and productive of a windfall gain to the party;[50] and

e. whether the clause was negotiated and freely entered into between parties who were of comparable bargaining power.[51]

54. The first two factors go against the characterization of a time-bar as a penalty, as it is almost always impossible to predict as at the date of the contract the loss or damage that could flow from a failure to give notice, irrespective of when the failure to give notice occurred. For instance, there might be upstream notice requirements that necessitate the subcontractor giving notice in a timely manner, as otherwise the head contractor will suffer a similar or equivalent loss to the principal, and the principal might also suffer a similar or equivalent loss to its financier. Likewise with a withholding provision, although these will always depend on the facts of the particular case.

55. In the English case of *GTC v Richmond*[52] the latter three factors saved a condition precedent that was a *prima facie* penalty. There, the defendant sold a company to the claimant and most of the consideration was in the form of loan notes. One condition for the sale was that the defendant would procure a loan guarantee for the company being sold, and if this was not done, then the claimant would be under no obligation to make any payment under the loan notes. The defendant argued that this condition was a penalty. The Court held that despite the clause imposing a condition precedent, the penalty rule applied.[53]

56. The Court held that although the distinction between a pre-estimate of damages and a penalty is at the core of the area of law, this does not cover all the possibilities. The Court then went on to a further step to consider the latter three considerations above, and held that:[54]

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[50] *GTC v Richmond* [2008] 2 Lloyds Rep 475, [45]; *Phillips Hong Kong Ltd v Attorney General of Hong Kong* [1993] 61 BLR 41, 58; *Esanda Finance Corporation Ltd v Plessnig* (1989) 166 CLR 131, [5]; *Elsley v. J.G. Collins Insurance Agencies Ltd* (1978) 83 DLR (3d) 1.

[51] *Alfred McAlpine Capital Projects Ltd v Tilebox Ltd* [2005] BLR 271, 280; *Multiplex Constructions Pty Ltd v Abgarus Pty Ltd* (1992) 33 NSWLR 504; *Yarra Capital Group Pty Ltd & Anor v Sklash Pty Ltd* [2006] VSCA 109 (Unreported, Warren CJ, Chernov and Ashley JJA, 18 May 2006).

[52] [2008] 2 Lloyds Rep 475.

[53] Ibid, [118].

[54] Ibid, [133] – [136].

a. The party subject to the alleged penalty was backed up by offshore companies and trusts, and was represented by two experienced business consultants (that is, there was equal bargaining power).
b. The company being sold was losing money and the buyers wanted security to ensure the company would survive. Also, the cancellation of the loan notes would improve its balance sheet position and would make it easier to obtain funding elsewhere (that is, the condition was commercially justifiable, and was not designed to deter breach).

57. These kinds of considerations have also arisen in Australia in the following cases:
a. *Bartercard Ltd v Myallhurst Pty Ltd*[55] in which the court held that although a particular clause might impose a windfall gain, there was commercial necessity for the relevant term to create an incentive for the bartercard scheme to continue in operation.
b. *AMEV Finance Ltd v Artes Studios Thoroughbreds Pty Ltd,*[56] in which Clarke JA considered that the penalty doctrine protects a weaker party from oppressive burdens or the unconscientious use of power by a stronger party.
c. *Multiplex Constructions Pty Ltd v Abgarus Pty Ltd*[57]*,* in which Cole J observed that an unconscionable burden may depend on the relationship of the parties including circumstances of the parties at the date of the contract including any equality or inequality of bargaining power.
d. *Yarra Capital Group Pty Ltd & Anor v Sklash Pty Ltd*[58] in which the Victorian Court of Appeal considered that unconscionability, including the relationship of the parties, was a consideration in the penalty doctrine.

58. Thus, arguments seeking to circumvent the characterization of clauses in construction contracts as penalties within the *Andrews* formula include:
a. the entitlement the contractor is claiming has not accrued, and therefore is not being withheld by operation of the clause;
b. the loss or damage that would be incurred by reason of the failure of the primary stipulation is insusceptible of evaluation at the date of the contract;

[55] [2000] QCA 445 (Unreported, Davies, Thomas JJA and Ambrose J, 27 October 2000), [5].
[56] (1989) 15 NSWLR 564.
[57] (1992) 33 NSWLR 504.
[58] [2006] VSCA 109 (Unreported, Warren CJ, Chernov and Ashley JJA, 18 May 2006).

c. the incurring of the collateral stipulation does not result in any windfall gain, and is otherwise not extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from the breach;
d. the clause has commercial justification, and is not designed to deter breach; or
e. the clause was negotiated freely between parties of equal bargaining power.

So how to you get around the penalty doctrine?

59. The penalty doctrine is a substance over form approach, so whenever the Court detects a penalty in whatever form, it is likely to give relief. However, the above factors tend to suggest the kind of drafting approaches that could result in a court finding that the clause is not a penalty.
60. Nevertheless, drafters should be warned that until the High Court gives clarification to the meaning of its formula in paragraph 10 of *Andrews*, any clause imposing a collateral stipulation to secure a primary stipulation is exposed to attack. It is possible that the High Court will revisit its *Andrews* formulation, or the scope of penalty doctrine generally, in the next phase of the *Andrews* litigation.

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