BAILII Citation Number: [1914] UKHL 1

HOUSE OF LORDS

Date: 01 July 1914

Between:

DUNLOP PNEUMATIC TYRE COMPANY, LIMITED — **APPELLANTS**

- v -

NEW GARAGE AND MOTOR COMPANY, LIMITED — **RESPONDENTS**

The House took time for consideration.

July 1.

LORD DUNEDIN.

My Lords, the appellants, through an agent, entered into a contract with the respondents under which they supplied them with their goods, which consisted mainly of motor-tyre covers and tubes. By this contract, in respect of certain concessions as to discounts, the respondents bound themselves not to do several things, which may be shortly set forth as follows: not to tamper with the manufacturers' marks; not to sell to any private customer or co-operative society at prices less than the current price list issued by the Dunlop Company; not to supply to persons whose supplies the Dunlop Company had decided to suspend; not to exhibit or to export without the Dunlop Company's assent. Finally, the agreement concluded (clause 5), "We agree to pay to the Dunlop Pneumatic Tyre Company, Ltd. the sum of 5 *l.* for each and every tyre, cover or tube sold or offered in breach of this agreement, as and by way of liquidated damages and not as a penalty."

The appellants, having discovered that the respondents had sold covers and tubes at under the current list price, raised action and demanded damages. The case was tried and the breach in fact held proved. An inquiry was directed before the Master as to damages. The Master inquired, and assessed the damages at 250 *l.* , adding this explanation: "I find that it was left open to me to decide whether the 5 *l.* fixed in the agreement was penalty or liquidated damages. I find that it was liquidated damages."

The respondents appealed to the Court of Appeal, when the majority of that Court, Vaughan Williams and Swinfen Eady L.JJ., held, Kennedy L.J. dissenting, that the said sum of 5 *l.* was a penalty, and entered judgment for the plaintiffs for the sum of 2 *l.* as nominal damages. Appeal from that decision is now before your Lordships' House.

My Lords, we had the benefit of a full and satisfactory argument, and a citation of the very numerous cases which have been decided on this branch of the law. The matter has been handled, and at no distant date, in the Courts of highest resort. I particularly refer to the Clydebank Case[(1)] in your Lordships' House and the cases of Public Works Commissioner v. Hills[(2)] and Webster v. Bosanquet[(3)] in the Privy Council. In both of these cases many of the previous cases were considered. In view of that fact, and of the number of the authorities available, I do not think it advisable to attempt any detailed review of the various cases, but I shall content myself with stating succinctly the various propositions which I think are deducible from the decisions which rank as authoritative:-

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 (Clydebank Engineering and Shipbuilding Co. v. Don Jose Ramos Yzquierdo y Castaneda[(1)]).

3. The question whether a sum stipulated is penalty or liquidated damages is a question of construction to be decided

(1) [1905] A. C. 6.
(2) [1906] A. C. 368.
(3) [1912] A. C. 394.

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 (Public Works Commissioner v. Hills[(1)] and Webster v. Bosanquet[(2)]).

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. (Illustration given by Lord Halsbury in Clydebank Case.[(3)]

(*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 (Kemble v. Farren[4]). This though one of the most ancient instances is truly a corollary to the last test. Whether it had its historical origin in the doctrine of the common law that when A. promised to pay B. a sum of money on a certain day and did not do so, B. could only recover the sum with, in certain cases, interest, but could never recover further damages for non-timeous payment, or whether it was a survival of the time when equity reformed unconscionable bargains merely because they were unconscionable, - a subject which much exercised Jessel M.R. in Wallis v. Smith[5] - is probably more interesting than material.

(*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" (Lord Watson in Lord Elphinstone v. Monkland Iron and Coal Co.[6]).

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

(1) [1906] A. C. 368.
(2) [1912] A. C. 394.
(3) [1905] A. C. 6.
(4) 6 Bing. 141.
(5) 21 Ch. D. 243.
(6) 11 App. Cas. 332.

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 (Clydebank Case, Lord Halsbury[1]; Webster v. Bosanquet, Lord Mersey[2]).

Turning now to the facts of the case, it is evident that the damage apprehended by the appellants owing to the breaking of the agreement was an indirect and not a direct damage. So long as they got their price from the respondents for each article sold, it could not matter to them directly what the respondents did with it. Indirectly it did. Accordingly, the agreement is headed "Price Maintenance Agreement," and the way in which the appellants would be damaged if prices were cut is clearly explained in evidence by Mr. Baisley, and no successful attempt is made to controvert that evidence. But though damage as a whole from such a practice would be certain, yet damage from any one sale would be impossible to forecast. It is just, therefore, one of those cases where it seems quite reasonable for parties to contract that they should estimate that damage at a certain figure, and provided that figure is not extravagant there would seem no reason to suspect that it is not truly a bargain to assess damages, but rather a penalty to be held in terrorem.

The argument of the respondents was really based on two heads. They overpressed, in my judgment, the dictum of Lord Watson in Lord Elphinstone's Case[3], reading it as if he had said that the matter was conclusive, instead of saying, as he did, that it raised a presumption, and they relied strongly on the case of Willson v. Love.[4]

Now, in the first place, I have considerable doubt whether the stipulated payment here can fairly be said to deal with breaches, "some of which" - I am quoting Lord Watson's words - "may occasion serious and others but trifling damage." As a mere matter of construction, I doubt whether clause 5 applies to anything but sales below price. But I will assume that it does. None the less the mischief,

as I have already pointed out, is an indirect mischief, and I see no data on which, as a matter

(1) [1905] A. C. at p. 11.
(2) [1912] A. C. at p. 398.
(3) 11 App. Cas. 332, at p. 342.
(4) [1896] 1 Q. B. 626.

of construction, I could settle in my own mind that the indirect damage from selling a cover would differ in magnitude from the indirect damage from selling a tube; or that the indirect damage from a cutting-price sale would differ from the indirect damage from supply at a full price to a hostile, because prohibited, agent. You cannot weigh such things in a chemical balance. The character of the agricultural land which was ruined by slag heaps in Elphinstone's Case[(1)] was not all the same, but no objection was raised by Lord Watson to applying an overhead rate per acre, the sum not being in itself unconscionable.

I think Elphinstone's Case[(1)], or rather the dicta in it, do go this length, that if there are various breaches to which one indiscriminate sum to be paid in breach is applied, then the strength of the chain must be taken at its weakest link. If you can clearly see that the loss on one particular breach could never amount to the stipulated sum, then you may come to the conclusion that the sum is penalty. But further than this it does not go; so, for the reasons already stated, I do not think the present case forms an instance of what I have just expressed.

As regards Willson's Case[(2)], I do not think it material to consider whether it was well decided on the facts. For it was decided on the view of the facts that the manurial value of straw and of hay were known ascertainable quantities as at the time of the bargain, and radically different, so that the damage resulting from the want of one could never be the same as the damage resulting from the want of the other.

Added to that, the parties there had said "penalty," and the effort was to make out that that really meant liquidated damages; and lastly, if my view of the facts in the present case is correct, then Rigby L.J. would have agreed with me, for the last words of his judgment are as follows: "On the other hand it is stated that, when the damages caused by a breach of contract are incapable of being ascertained, the sum made by the contract payable on such a breach is to be regarded as liquidated damages. The question arises, What is meant in this statement by the expression 'incapable of being ascertained'? In their proper sense the words appear to refer to a case where no rule or measure

(1) 11 App. Cas. 332.
(2) [1896] 1 Q. B. 626.

of damages is available for the guidance of a jury as to the amount of the damages, and a judge would have to tell them they must fix the amount as best they can." To arrive at the indirect damage in this case, supposing no sum had been stipulated, that is just what a judge would, in my opinion, have had to do.

On the whole matter, therefore, I go with the opinion of Kennedy L.J., and I move your Lordships that the appeal be allowed, and judgment given for the sum as brought out by the Master, the appellants to have their costs in this House and in the Courts below.

LORD ATKINSON. My Lords, the action out of which this appeal arises was brought upon a contract entered into between the appellants, through the agency of Messrs. Pellant, Limited, and

the respondents, claiming, amongst other things, to recover a sum of 5 *l.* in respect of each of the breaches of this contract complained of. The sole question for decision on this appeal is whether this sum of 5 *l.* is a penalty or liquidated damages.

The appellants are extensive and well-known manufacturers of motor tyres, covers, and tubes, a trade in which there is keen competition. They have no patents protecting their manufacture. Success over their competitors depends on the reputation acquired for their products, and largely upon the efficiency of the organization of their business. Ninety-nine per cent. of their output in this class of goods is sold through what Mr. Baisley, one of their managers who was examined as a witness, described as their distributing organization. It consists in this, that they sell to motor car manufacturers, persons called factors who resell to retail agents, and retail agents themselves, and that all these latter sell to the public, the users of the goods.

The appellants produce price lists of these goods of theirs varying from time to time. They invariably sell at these prices to the members of their distributing organization under agreements similar to that sued upon, giving, however, discount and rebates at varying rates. These agreements are styled price maintenance agreements, and their main purpose, obviously, is to prevent the sale to the public, the users, either directly or indirectly, of the goods the appellants manufacture at prices less than those named in their price lists. The result of this is that, competition having reduced these prices to the lowest remunerative scale, the agent secures his remuneration by selling at the prices at which he buys. If he sells at lower prices than these the loss comes out of his discount and rebates, his own profits. Mr. Baisley, in his evidence (Appendix, pp. 111 - 116), explains elaborately the dislocation of the distributing organization of the appellants, and the injury to their trade which would ensue from the sale by one or more of their agents or factors of their goods at prices less than those named in these lists. He pointed out that if the business of one of their agents in any particular place was undercut by such sales, the agent would, owing to the diminution of his remuneration, most probably throw up his agency and become the agent of a competitor, thus leaving the field open to the rivals of the appellants; that it was essential for their trade that their wares should be obtainable all over the country at as many places as possible, and that though the consequential injury to their trade by this undercutting would, or might, be very serious, it would be very difficult to prove in evidence the precise amount of their loss in money; that considering all these things, the appellant company fixed 5 *l.* , the sum mentioned in the agreement, as a fair and reasonable sum for liquidated damages in respect of the breaches specified. This evidence was uncontradicted.

In a good deal of the argument which has been addressed to your Lordships on behalf of the respondents, the true object of this price maintenance agreement, and the nature of the consequential injury to the plaintiffs' trade flowing from the breaches of it, have been somewhat lost sight of. It has been urged that as the sum of 5 *l.* becomes payable on the sale of even one tube at a shilling less than the listed price, and as it was impossible that the appellant company should lose that sum on such a transaction, the sum fixed must be a penalty. In the sense of direct and immediate loss the appellants lose nothing by such a sale. It is the agent or dealer who loses by selling at a price less than that at which he buys, but the appellants have to look at their trade in globo, and to prevent the setting up, in reference to all their goods anywhere and everywhere, a system of injurious undercutting.

The object of the appellants in making this agreement, if the substance and reality of the thing and the real nature of the transaction be looked at, would appear to be a single one, namely, to prevent the disorganization of their trading system and the consequent injury to their trade in many directions. The means of effecting this is by keeping up their price to the public to the level of their price list, this last being secured by contracting that a sum of 5 *l.* shall be paid for every one of the

three classes of articles named sold or offered for sale at prices below those named on the list. The very fact that this sum is to be paid if a tyre cover or tube be merely offered for sale, though not sold, shows that it was the consequential injury to their trade due to undercutting that they had in view. They had an obvious interest to prevent this undercutting, and on the evidence it would appear to me impossible to say that that interest was incommensurate with the sum agreed to be paid.

Their object is akin in some respects to that which a trader has in binding a former employee not to set up, or carry on, a rival business within a certain area. The trader's object is to prevent competition, and especially to prevent his old customers whom the employee knows from being enticed away from him. If one takes for example the case of a plumber, the carrying on of the trade of a plumber may mean anything from mending gas pipes for a few pence apiece up to doing all the plumbing work of a big hotel. If the employee should mend one hundred of such pipes for twenty old customers at 6 *d.* apiece, for which the employer would charge 1 *s.* apiece, could it possibly be contended that the trader's loss was only one hundred sixpences, 2 *l.* 10 *s.* ? It is, I think, quite misleading to concentrate one's attention upon the particular act or acts by which, in such cases as this, the rivalry in trade is set up, and the repute acquired by the former employee that he works cheaper and charges less than his old master, and to lose sight of the risk to the latter that old customers, once tempted to leave him, may never return to deal with him, or that business that might otherwise have come to him may be captured by his rival. The consequential injuries to the trader's business arising from each breach by the employee of his covenant cannot be measured by the direct loss in a monetary point of view on the particular transaction constituting the breach. An old customer may be as effectively enticed away from him through the medium of a 10 *s.* job done at a cheap rate as by a 50 *l.* job done at a cheap rate, or a reputation for cheap workmanship may be acquired possibly as effectively in one case as in the other.

In many cases a person may contract to do or abstain from doing an act which is a composite act, the product or result of almost numberless other acts. For instance, if one should contract with a builder to build a house of the best materials and with the most skilled workmanship, and to hand over possession of the same completed on a certain day for 1000 *l.* , 500 *l.* to be paid if the agreement was not performed; every fire grate set which on completion would be found to be of bad material, every door which would be found to have been defectively hung, every cubic foot of masonry which would be found to have been badly and improperly built, would involve a breach of the agreement, but it would be quite illegitimate to thus disintegrate the obligation to do what the parties regarded as a single whole into a number of obligations to do a number of things of varying importance, and treat the 500 *l.* as prima facie a penalty, because these individual breaches of the agreement did not cause, in many instances, any injury commensurate with that sum. This is the very ground, or one of the grounds, upon which Lord Herschell rests his judgment in Lord Elphinstone v. Monkland Iron and Coal Co.[(1)] He said, "The agreement does not provide for the payment of a lump sum upon the non-performance of any one of many obligations differing in importance. It has reference to a single obligation, and the sum to be paid bears a strict proportion to the extent to which that obligation is left unfulfilled."

In the present case the agreement of the parties, in effect, though possibly not in form, did little, if anything, more than impose a single obligation, namely, to sell and endeavour to sell the goods of the appellants at the prices named in their lists,

(1) 11 App. Cas. 332, at p. 345.

though, of course, as they sold different kinds of goods, this single obligation might be violated in many ways. Much reliance was placed by the respondents on the well-known passage in the

judgment of Lord Watson in the last-mentioned case, to the effect that "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, the presumption is that the parties intended the sum to be penal, and subject to modification." It is quite true that, as mentioned by Swinfen Eady L.J., Lord Esher, in Willson v. Love[(1)], said that he thought this passage meant the same thing as if it ran "some of which may occasion serious and others less serious damage." With all respect, this alteration would mean that the damage resulting from each event should be almost uniform in amount, a construction which would mean that the stipulated compensation must presumably be a penalty in almost every conceivable case. Moreover, Lord Watson's statement of the law as it stands was approved by Lord Davey in Clydebank Engineering and Shipbuilding Co. v. Don Jose Ramos Yzquierdo y Castaneda[(2)] and in Webster v. Bosanquet[(3)] without any qualification of that kind.

In this last-mentioned case, as in the present, the contract provided that the amount specified should be paid as "liquidated damages and not as a penalty." The covenant upon which the matter in controversy turned was contained in a deed made on the dissolution of a partnership between two partners, the plaintiff and defendant, and it provided that the defendant should not during a certain period be at liberty to sell the whole or part of the tea crops of two estates named to any person other than the plaintiff without first offering to him the option of buying the same, and further provided that on breach of this covenant by the defendant he should pay to the petitioner the sum of 500 *l.* as "liquidated damages and not as a penalty."

Now, it will be observed that this covenant would be violated by the sale of any appreciable part, in a business point of view, of the crops of either of these estates, no matter how relatively

(1) [1896] 1 Q. B. 626, at p. 630.
(2) [1905] A. C. 6.
(3) [1912] A. C. 394.

small that part might be compared with the entire crop of either. It is also clear that the object of the parties when they executed the deed was to secure to the plaintiff the option of buying the entire crops of both estates, and that when they fixed this sum of 500 *l.* they were thinking of the loss the plaintiff might sustain by the loss of that option. The amount of tea sold by the defendant in breach of the covenant was considerable - nearly 54,000 lbs. It was laid down that in determining whether a sum contracted to be paid is liquidated damages or a penalty, one is to consider whether the contract, whatever its language, would, at the time it was entered into, have been unconscionable and extravagant, and one which no Court ought to allow to be enforced if this sum were to be treated as liquidated damages, having regard to any possible amount of damage likely to have been in the contemplation of the parties when they made the contract. At p. 398, Lord Mersey, in delivering the judgment of the Judicial Committee, said: "When making the contract it was impossible to foresee the extent of the injury which might be sustained by the plaintiff if sales of the tea were made to third parties without his consent. That such sales might seriously affect his business was obvious, and the very uncertainty of the loss likely to arise made it most reasonable for the parties to agree beforehand as to what the damages should be. And, furthermore, it is well known that damages of this kind, though very real, may be difficult of proof, and that the proof may entail considerable expense." Those remarks are, having regard to the evidence in the present case, particularly applicable to it.

In Kemble v. Farren[(1)] Tindal C.J. said: "We see nothing illegal or unreasonable in the parties, by their mutual agreement, settling the amount of damages, uncertain in their nature, at any sum upon which they may agree. In many cases, such an agreement fixes that which is almost impossible to

be accurately ascertained; and in all cases, it saves the expense and difficulty of bringing witnesses to that point."

Therefore, although it may be true, as laid down by Lord Watson, that a presumption is raised in favour of a penalty

(1) 6 Bing. 141, at p. 148.

where a single lump sum is to be paid by way of compensation in respect of many different events, some occasioning serious, some trifling damage, it seems to me that that presumption is rebutted by the very fact that the damage caused by each and every one of those events, however varying in importance, may be of such an uncertain nature that it cannot be accurately ascertained. The damage has been proved to be of that nature in the present case, and the very fact that it is so renders it all the more probable that the sum of 5 *l.* was not stipulated for merely in terrorem, but was really and genuinely a pre-estimate of the appellants' probable or possible interest in the due performance of the contract.

Swinfen Eady L.J. holds that clause No. 5 of the agreement applies to the first part of clause 3, the supplying of these goods to persons on the appellants' black list, as it was styled. I confess that seems to me a very, very doubtful construction. What is prohibited by the second clause is "the sale or offering for sale of motor tyres, covers, or tubes at prices less than those in the price list." What is dealt with in clause 5 is a sale or offering for sale of these particular kinds of goods in breach of the agreement. What is dealt with in the first part of clause 3 is the supply without consent of any such goods to these blacklisted agents at any price whatever; but even if Swinfen Eady L.J. should be right in this it would not lead me to a conclusion different from that to which I have come.

The appellants, like the respondents, are most probably good business men. Neither of them contemplated, presumably, the black-listing of these agents without adequate trade reasons. Nothing was more natural than that the appellants should seek to prevent the supply of their goods indirectly to persons to whom they would not supply them directly. Considerable injury to their trade interests might obviously be done by putting such persons in a position to undercut their prices, and derange their supply organization, and nothing conceivable could be more difficult than to prove by evidence, or to estimate precisely in money, the exact amount of damages which might be caused by such an injury. The passage in the judgment of Tindal C.J., above quoted, applies directly to such state of things.

I entirely concur with Kennedy L.J. in his criticism of the agreement to be found at p. 134 of the appendix. I agree with him that on the face of it, on this point of liquidated damages, it contains nothing unreasonable, unconscionable, or extravagant. And I further think that the same may be said of the real transaction between the parties if its substance be reasonably regarded.

For these reasons I think that the judgment of Kennedy L.J. was right, that the judgment appealed from was wrong and should be reversed, and the judgment of Phillimore J. be restored, and the appeal allowed with costs.

LORD PARKER OF WADDINGTON. (1)My Lords, where the damages which may arise out a breach of contract are in their nature uncertain, the law permits the parties to agree beforehand the amount to be paid on such breach. Whether the parties have so agreed or whether the sum agreed to be paid on the breach is really a penalty must depend on the circumstances of each particular case. There are, however, certain general considerations which have to be borne in mind in

determining the question. If, for example, the sum agreed to be paid is in excess of any actual damage which can possibly, or even probably, arise from the breach, the possibility of the parties having made a bona fide pre-estimate of damage has always been held to be excluded, and it is the same if they have stipulated for the payment of a larger sum in the event of breach of an agreement for the payment of a smaller sum.

The really difficult cases are those in which the Court has to consider what presumptions or inferences arise from the number or nature of the stipulations on breach of which the sum in question is agreed to be paid. In the case of a single stipulation, which, if broken at all, can be broken once only, and in one way only, such as a covenant not to reveal a trade secret to a rival trader, there can be no inference or presumption that the sum payable on breach is not in the nature of agreed damages, and if the parties have referred to it as agreed or liquidated damages, no reason why the Court should not treat it as such. The

(1) Road by Lord Shaw of Dunfermline.

question is more complicated when the stipulation, though still a single stipulation, is capable of being broken more than once, and in more ways than one, such as a stipulation not to solicit the customers of a firm. A solicitation which is unsuccessful can give rise to only nominal damages, and even if it be successful, the actual damage may vary greatly according to the value of the custom which is thereby directly or indirectly lost to the firm. Still, whatever damage there is must be the same in kind for every possible breach, and the fact that it may vary in amount for each particular breach has never been held to raise any presumption or inference that the sum agreed to be paid is a penalty, at any rate in cases where the parties have referred to it as agreed or liquidated damages.

The question becomes still more complicated where a single sum is agreed to be paid on the breach of a number of stipulations of varying importance. It is said that in such a case there arises an inference or presumption against the sum in question being in the nature of agreed damages, even though the parties have referred to it as such. My Lords, in this respect I think a distinction should be drawn between cases in which the damage likely to accrue from each stipulation is the same in kind and cases in which the damage likely to accrue varies in kind with each stipulation. Cases of the former class seem to me to be completely analogous to those of a single stipulation, which can be broken in various ways and with varying damage; but probably it would be difficult for the Court to hold that the parties had pre-estimated the damage if they have referred to the sum payable as a penalty.

In cases, however, of the latter class, I am inclined to think that the prima facie presumption or inference is against the parties having pre-estimated the damage, even though the sum payable is referred to as agreed or liquidated damages. The damage likely to accrue from breaches of the various stipulations being in kind different, a separate pre-estimate in the case of each stipulation would be necessary, and it would not be very likely that the same result would be arrived at in respect of each kind of damage. In my opinion, however, any such presumption or inference would be prima facie only and capable of being displaced by other considerations. Supposing it were recited in the agreement that the parties had estimated the probable damage from a breach of one stipulation at from 5 *l.* to 15 *l.* , and the probable damage from a breach of another stipulation at from 2 *l.* to 12 *l.* , and had agreed on a sum of 8 *l.* as a reasonable sum to be paid on the breach of either stipulation, I cannot think that the Court would refuse to give effect to the bargain between the parties.

My Lords, in the present case, even accepting the construction of the contract which makes clause

5 apply not only to a sale or offer contrary to the provisions of clause 2, but also to one contrary to the provisions of clause 3, I think it is reasonably clear that the damage likely to accrue from the breach of every stipulation to which clause 5 applies is the same in kind. Such damage will in every case consist in the disturbance or derangement of the system of distribution by means of which the appellants' goods reach the ultimate consumer. The parties by their contract agree that the sum payable on breach of any such stipulation is to be paid by way of damages and not by way of penalty, and I can see nothing to justify the Court in refusing to give effect to this bargain.

LORD PARMOOR. My Lords, on April 7, 1911, Messrs. A. Pellant, Limited (acting as agents for the appellants), entered into a price maintenance agreement with the respondents. The question to determine is the construction of this agreement.

In the fifth clause the respondents agreed to pay to the appellants "the sum of 5 *l.* for each and every tyre, cover, or tube sold or offered in breach of this agreement, as and by way of liquidated damages, and not as a penalty." There has been difference of opinion whether the sum of 5 *l.* is applicable only to a breach of the conditions contained in paragraph 2 of the agreement or extends to a breach of other conditions not contained in this paragraph.

Paragraph 2 contains an undertaking by the respondents that they "will not sell or offer any Dunlop motor tyres, covers, or tubes to any private customers or to any co-operative society at prices below those mentioned in the price list current at the time of sale, nor give to any such customer or society any cash or other discounts, or advantages reducing the same, and will not sell or offer any Dunlop motor tyres, covers, or tubes to any other person, firm, or company at prices less than those mentioned in the said price list." I agree with the opinion of Kennedy L.J. that under the terms of the contract the sum of 5 *l.* is only payable in respect of a breach of the undertaking in paragraph 2 of the contract, and does not extend to other breaches. I further agree with the opinion expressed by the Lord Justice, that, within this limitation, clause 5 of the contract does apply to more than one contingency, and that the case must be considered on this basis.

It was held by the Court of Appeal that although the sum of 5 *l.* was agreed between the parties to be by way of liquidated damages and not as a penalty, yet it must be regarded as a penalty; that the appellants could not recover any greater damages for breach of the agreement in the sale or offering of any tyre, cover, or tube than such damage as they could prove that they had sustained; since they could not prove that they had sustained actual damage, they were not entitled to more than nominal damages. It is against this decision that the appeal is brought to your Lordships' House.

My Lords, there is no question as to the competency of parties to agree beforehand the amount of damages, uncertain in their nature, payable on the breach of a contract. There are cases, however, in which the Courts have interfered with the free right of contract, although the parties have specified the definite sum agreed on by them to be in the nature of liquidated damages, and not of a penalty. If the Court, after looking at the language of the contract, the character of the transaction, and the circumstances under which it was entered into, comes to the conclusion that the parties have made a mistake in calling the agreed sum liquidated damages, and that such sum is not really a pactional pre-estimate of loss within the contemplation of the parties at the time when the arrangement was made, but a penal sum inserted as a punishment on the defaulter irrespective of the amount of any loss which could at the time have been in contemplation of the parties, then such sum is a penalty, and the defaulter is only liable in respect of damages which can be proved against him. It is too late to question whether such interference with the language of a contract can be justified on any rational principle.

There are two instances in which the Court has interfered when the agreed sum is referable to the breach of a single stipulation. It is important that the principle of interference should not be extended. The agreed sum, though described in the contract as liquidated damages, is held to be a penalty if it is extravagant or unconscionable in relation to any possible amount of damages that could have been within the contemplation of the parties at the time when the contract was made. No abstract rule can be laid down without reference to the special facts of the particular case, but when competent parties by free contract are purporting to agree a sum as liquidated damages there is no reason for refusing a wide limit of discretion. To justify interference there must be an extravagant disproportion between the agreed sum and the amount of any damage capable of pre-estimate. In the case of Clydebank Engineering and Shipbuilding Co. v. Don Jose Ramos Yzquierdo y Castaneda(1) Lord Halsbury gives an apt illustration of what would probably render a sum agreed by the parties unconscionable, and therefore a penalty: "For instance, if you agreed to build a house in a year, and agreed that if you did not build the house for 50 *l.* you were to pay a million of money as a penalty, the extravagance of that would be at once apparent."

In the present case the definite sum agreed by the parties is 5 *l.* , and this cannot be said to be extravagant or extortionate, having regard to the nature of the contract.

The second instance in which the Courts have sanctioned interference is in the case of a covenant for a fixed sum, or for a sum definitely ascertainable, and where a larger sum is inserted by arrangement between the parties, payable as liquidated damages in default of payment. Since the damage for the breach of covenant is in such cases by English law capable of exact definition, the substitution of a larger sum as liquidated damages is regarded, not as a pre-estimate of damage, but as a penalty in the

(1) [1905] A. C 6.

nature of a penal payment. In the present case this limitation has no application. It cannot be said that the sum of 5 *l.* is being substituted for the payment of a smaller fixed or ascertainable sum, since from the nature of this contract any accurate pre-estimate of damage would be practically impossible. The words of Tindal C.J. in the case of Kemble v. Farren(1) are directly applicable: "We see nothing illegal or unreasonable in the parties, by their mutual agreement, settling the amount of damages, uncertain in their nature, at any sum upon which they may agree. In many cases, such an agreement fixes that which is almost impossible to be accurately ascertained; and in all cases, it saves the expense and difficulty of bringing witnesses to that point."

My Lords, the point on which the majority of the Court of Appeal decided this case against the appellants is that, where a contract contains varying stipulations, and the evidence shows that these stipulations are of varying degrees of importance, the Court exercises a wider power of interference, and a single sum made payable by the occurrence of the breach of one or more, or all of such stipulations, is prima facie a penalty and not liquidated damages. If this statement of the law is accurate without limitation, the agreed sum of 5 *l.* in the present case would be in the nature of a penalty, since that sum is fixed irrespective of the varying degrees of importance of the stipulations. I agree with Kennedy L.J., that though the fact that the agreed sum covers more than one event is an element in the case, or may constitute a presumption that it is a penalty, it is in no sense conclusive against such sum being treated as liquidated damages. There may be a greater risk of infringing the principle against extortion, or against the substitution of a larger for a smaller payment, in applying the same figure to a number of different breaches of varying importance, more especially if some occasion serious and others but trifling damage, than when it is applied to one breach; but if these tests are complied with the parties may reasonably be allowed to make their own agreement. No doubt if the agreed sum is not applied distributively, but equally to

stipulations of varying importance, and in reference to any of the stipulations it

(1) 6 Bing. 141, at p. 148.

is a penalty, it is a penalty for the purpose of the whole contract, since it could not in the same contract be construed both as a penalty and as liquidated damages.

If the same agreed sum, separately allocated in different agreements to breaches of varying importance, could be properly construed as a pre-estimate of damage, it seems illogical to regard such sum as a penal payment because for convenience or economy the whole transaction is included in one agreement. The present case is an illustration in point. Having regard to the character of the contract, it would have been possible to have a series of contracts applicable to the various stipulations, and to have inserted in each of them a sum of 5 *l.* as liquidated damages to compensate a loss uncertain, and practically incapable of ascertainment, at the time when the contract was made. I can see no reason why the parties should not be allowed to contract in one document instead of several, or that in such a case the law should interfere with freedom of contract.

Swinfen Eady L.J. in the Court of Appeal largely bases his judgment on the case of Willson v. Love.(1) In that case there was a covenant by the lessees of a farm not to sell hay or straw off the premises during the last twelve months of the term, and a provision that an additional rent of 3 *l.* per ton should be payable by way of penalty for every ton of hay or straw so sold. There was a substantial difference between the manurial value of hay and that of straw, and it was held that the sum so made payable was a penalty and not liquidated damages.

It is noticeable in this case that the parties expressed the sum to be a penalty, and not liquidated damages, but in giving judgment A. L. Smith L.J. says: "Where a sum is made payable by a contract to secure the performance of several stipulations, the damages for the breach of which respectively must be substantially different, or, in other words, the performance of stipulations of varying degrees of importance, that sum is prima facie to be regarded as a penalty and not as liquidated damages." If the words "prima facie" only apply to a presumption which can be displaced, then I agree with Kennedy L.J. that the presumption is displaced in the present case, which belongs to a class in which

(1) [1896] 1 Q. B. 626.

it is practically impossible to make an accurate pre-estimate of damage, and there is no question of extortion or of substituting a larger for a smaller sum. But if the words "prima facie" imply that the sum will be regarded as a penalty unless there are some special circumstances which could justify an opposite conclusion the statement appears to be expressed in too general terms.

In the case of Wallis v. Smith(1), tried before Fry J., and taken to the Court of Appeal, it was necessary to decide whether when a contract contained a condition for payment of a sum of money as liquidated damages for the breach of stipulations of varied importance, none of which is for payment of an ascertained sum of money, the sum named should be treated as liquidated damages or as a penalty. All the previous cases were examined in the Court of Appeal, and the Court unanimously confirmed the judgment of Fry J., that the agreed sum was not a penalty but liquidated damages. Lindley L.J. says(2): "When I come to look at the cases I cannot find a single case in which the larger sum has been treated as penalty where there has been no smaller sum ascertainable as the amount of damages."

Cotton L.J. says(3): "There are a number of covenants to which clause 25 applies, and in respect of the breach of which it is said that 5000 *l.* shall be liquidated damages. Now in what cases have the Courts said that in those circumstances you shall construe the words 'liquidated damages,' not as what they mean - as a sum assessed between the parties - but only as a penal sum, leaving the real damages to be ascertained? Undoubtedly the authorities do say this, that when a stipulation applies to a breach of a number of covenants, and one of those is a covenant for the payment of a sum of money where the damage for the breach of it is according to English law capable of being actually defined, then where a sum is said to be liquidated damages the stipulation applies, not distributively to the different covenants but equally to all, and you must hold that the sum cannot be damages assessed by the parties as in the case of a particular covenant with respect to which the damages are incapable of being ascertained and are by law fixed in a different way; but

(1) 21 Ch. D. 243.
(2) 21 Ch. D. at p. 275.
(3) 21 Ch. D. at p. 268.

you must look upon it as a mere penalty, and ascertain when the breach occurs what is the damage sustained in respect of the particular breach."

In the present case there is no question of extortion or of giving a larger sum as liquidated damages for a fixed or ascertainable sum, in reference to any of the stipulations to which the agreed figure is applicable, and no ground for altering the terms of the contract as arranged by the parties. The parties adopted a wise and prudent course, having regard to the nature of the contract and the practical impossibility of an accurate ascertainment of damages.

My Lords, in my opinion this appeal should be allowed with costs.