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THE “LEGITIMATE INTEREST IN PERFORMANCE” IN THE LAW ON PENALTIES

Solène Rowan*

I. INTRODUCTION

In the conjoined appeals of *Cavendish Square Holding BV v Talal El Makdessi* and *ParkingEye Ltd v Beavis*,¹ the Supreme Court rewrote the law on penalties. It jettisoned the familiar requirement that an agreed damages clause² must be a genuine pre-estimate of loss in order to be enforceable and shifted the inquiry to whether the clause is justifiable and not unconscionable. A damages clause is now enforceable if it creates a secondary obligation which seeks to protect a legitimate interest of the injured party in the performance of the contract and imposes a detriment which is not out of all proportion in comparison to that interest.³

The concept of “legitimate interest in performance” is at the heart of this new test and therefore of considerable practical importance. However, it was left undefined by the Supreme Court, which gave only the following general guidance on what might or might not constitute a legitimate interest: there can be no legitimate interest in punishing the defaulting party;⁴ in many cases, compensation adequately serves the legitimate interest of the injured party;⁵ there may be circumstances in which the injured party has an interest in the enforcement of the primary obligation which is not satisfied by the recovery of compensatory damages;⁶ where the injured party has an interest that goes beyond compensation, a damages clause that has no relationship with loss and which aims to deter breach may be justified.⁷

In the absence of more precise judicial guidance, the reformulation of the rule on penalties around the requirement of a legitimate interest raises a number of questions. What is a legitimate interest in performance that extends beyond compensation? What considerations should be taken into account in determining whether there is such an interest? In what circumstances is the interest likely to be made out? These questions will inevitably arise in practice, particularly where damages clauses seek not simply to compensate but to achieve wider and non-compensatory objectives.

There are no clear answers to these questions, whether in *Makdessi* or the ensuing literature on the case.⁸ Some clues can however be found in brief references that were made

* My thanks are owed to Gregg Rowan and the editor and the anonymous referees of the *Cambridge Law Journal* for their comments on earlier drafts of this article. I am also grateful to Nick McBride for providing me with materials on the “legitimate interest” requirement in other contexts than remedies for breach of contract and to Charlotte Thomas of Brick Court Chambers for sharing her BCL dissertation, “Reconceptualising *White and Carter*”.

¹ [2016] A.C. 172. For ease of reference, the conjoined appeals will be referred to in this article simple as *Makdessi*.

² Or another type of clause that falls within the scope of the penalty rule.

³ At [32] per Lord Neuberger and Lord Sumption; [152] per Lord Mance; [255] per Lord Hodge.

⁴ At [32] per Lord Neuberger and Lord Sumption; [243] per Lord Hodge.

⁵ At [32] per Lord Neuberger and Lord Sumption; [255] per Lord Hodge.

⁶ At [28]-[32], [99] Lord Neuberger and Lord Sumption; [152] per Lord Mance; [255] per Lord Hodge.

⁷ *Ibid.*

⁸ The exceptions are H. Beale (ed.), *Chitty on Contracts*, 32nd edn. (London 2015) at [26-198]-[21-210] which contains a short but excellent section that seeks to identify some of the situations in which an injured party is likely to have a legitimate interest in performance that goes beyond compensation and the Scottish Law

by the Supreme Court to principles that apply elsewhere in the law on remedies where concepts of legitimate interest in performance have featured in the court's reasoning.⁹ These are the exercise of the right to affirm following a repudiatory breach and specific performance. This article seeks to examine these clues and the contexts in which the courts have previously drawn upon a legitimate interest in performance. Its purpose is to bring clarity to what is meant by legitimate interest in performance in the context of penalties, as well as to make suggestions as to the circumstances in which damages clauses which go beyond simply compensating the injured party's loss will be acceptable.

The discussion begins with a survey of the antecedents of the legitimate interest in performance in the law on remedies. It has been turned to by the courts in other areas not only including the right to affirm following a repudiatory breach and specific performance, as the Supreme Court noted, but also gain-based damages.¹⁰ This is followed by analysis of how "legitimate interest" operates in these areas and the extent of the parallels with the legitimate interest in the context of the rule on penalties. It seeks to show that there are some potentially helpful parallels but it is not possible to distil from them clear guidance as to how the new test will operate. Indeed, possibly adding to the confusion, there are similar uncertainties as to the meaning of legitimate interest in at least some of these areas. On the current case law, the concept of legitimate interest is surprisingly hard to pin down. Important questions therefore remain.

The article then assesses what considerations are or might be relevant in determining whether a party has a legitimate interest in performance that goes beyond compensation. These are divined by analysing *Makdessi*, some post-*Makdessi* cases, and also case law in the other contexts cited by the Supreme Court as well as gain-based damages. Relevant considerations include the importance of the obligation to which the damages clause attaches, the seriousness of the consequences of its breach, the impact on the interests of third parties, the protection of the public interest, the protection of non-financial expectations, and the presence or absence of certain characteristics in the contracting parties. The conclusion drawn is that a damages clause which goes beyond the injured party's loss is more likely to be acceptable where it relates to an essential obligation of the contract, the breach of which could have serious consequences, and/or it protects the interests of third parties or the public in general, or non-monetary expectations. Such an outcome is particularly likely where the clause has been agreed by sophisticated contracting parties.

Commission's *Discussion Paper on Penalty Clauses* No 162 (2016) at paras 3.23-3.26, 3.49, 3.51, 3.55-3.59, 3.62, 5.38-5.61 and *Report on Review of Contract Law: Formation, Interpretation, Remedies for Breach of Contract, and Penalty Clauses* No 252 (2018) at paras 20.20-20.26, which contain very useful materials on the "legitimate interest" requirement. The topic is however fertile ground for further analysis and this paper elaborates upon, adds to, and also diverges from the conclusions of *Chitty* and the Scottish Law Commission. The aim of the article is to explore the requirement in depth rather than to criticise it and suggest more fitting solutions. It has already been the subject of extensive criticism in the literature, see: A. Summers, "Unresolved Issues in the Law on Penalty" L.M.C.L.Q. 95; F. Dawson, "Determining Penalties as a Matter of Construction" [2016] L.M.C.L.Q. 207; J. Morgan, "The Penalty Clause Doctrine: Unlovable but Untouchable" [2016] C.L.J. 11; C. Conte, "The Penalty Rule Revisited" (2016) 132 LQR 382; J. Fisher, "Rearticulating the Rule Against Penalty Clauses" [2016] LMCLQ 169.

⁹ At [29]-[30] per Lord Neuberger and Lord Sumption.

¹⁰ The article focuses on the role of "legitimate interest in performance" in the context of remedies for breach of contract as this is most relevant to damages clauses. "Legitimate interest" also has a role in the law of restraint of trade (*Countrywide Assured Financial Services Ltd v Smart* [2004] EWHC 1214 (Ch.)), the assignment of a right to sue for damages in tort (*Simpson v Norfolk and Norwich University Hospital NHS Trust* [2012] Q.B. 640), and the law of conspiracy (*Crofter Hand Woven Harris Tweed & Co Ltd v Veitch* [1942] A.C. 453).

II. THE “LEGITIMATE INTEREST IN PERFORMANCE” IN *MAKDESSI*

In laying down the new rule on penalties, the Supreme Court did not dwell on the meaning of the injured party's legitimate interest in performance. It did however give general guidance on when compensation will fulfil the interest and also the relatively rare circumstances in which the interest will go beyond compensation.

A. The Legitimate Interest in Performance Rarely Extends Beyond Compensation

Although the Supreme Court in *Makdessi* did not analyse the legitimate interest in performance, several points that are helpful to understanding the requirement emerge from the various judgments of the court. First, the legitimate interest of the injured party is in the enforcement of the primary obligation or in some appropriate alternative to performance.¹¹ Second, the nature and breadth of the interest varies from case to case.¹² And third, the aim of the court's inquiry into the legitimate interest is to determine the appropriate remedial response to the defaulting party's failure to perform. In particular, it seeks to establish whether the injured party's interest in performance is fulfilled by compensation or only a remedial response that goes beyond compensation will suffice.

The principal judgment, given jointly by Lord Neuberger and Lord Sumption, with whom Lord Clarke and Lord Carnwath agreed, makes clear that in many situations the interest of the injured party will be satisfied by monetary compensation alone. As they put it, “in straightforward damages cases, that interest will rarely extend beyond compensation for breach, and we therefore expect that Lord Dunedin's four tests would usually be perfectly adequate to determine its validity”.¹³ This is unsurprising. The purpose of a great many damages clauses is simply to compensate the loss resulting from the breach, and this is achieved by fixing in advance the level of damages that are payable in respect of the loss. This gives certainty to the parties regarding the quantum of damages that will be payable and, for the defaulting party, as to its potential liability.

It is therefore clear that, where damages clauses are intended to be compensatory in nature, loss remains the main yardstick for assessing their validity. As a result, the exercise undertaken by the courts before *Makdessi* of comparing the stipulated sum against the foreseeable loss resulting from breach is still relevant. A compensatory clause will continue to be a penalty and unenforceable if the agreed level of damages is exorbitant or wholly disproportionate in comparison with “the highest level of damages that could possibly arise from the breach”.¹⁴

That the legitimate interest of the injured party will rarely extend beyond compensation is consistent with the central role of compensation in remedies that arise by operation of law. Compensatory damages are at the top of the hierarchy of remedies for breach.¹⁵ Compensating the injured party's losses is perceived to be the most satisfactory and effective way of protecting his contractual expectations. It is only where his expectations are not satisfactorily fulfilled by compensation that the question arises as to whether another remedial response may be more suitable.

¹¹ At [32] per Lord Neuberger and Lord Sumption; [255] per Lord Hodge.

¹² At [28]-[32], [99] per Lord Neuberger and Lord Sumption; [152] per Lord Mance; [255] per Lord Hodge.

¹³ At [32] per Lord Neuberger and Lord Sumption; [255] per Lord Hodge.

¹⁴ At [255] per Lord Hodge.

¹⁵ A. Burrows, “Damages for Breach of Contract: A Developing Hierarchy?” (2003) 35 *Bracton L.J.* 28, 43.

B. The Legitimate Interest in Performance Can Extend Beyond Compensation

The Supreme Court in *Makdessi* emphasised that there are however circumstances in which the injured party's contractual expectations are not satisfied by compensation.¹⁶ To protect these expectations, the parties may wish to agree a damages clause that provides for damages in excess of the injured party's loss and has broader, non-compensatory objectives including the deterrence of breach. Since *Makdessi*, loss is no longer the only benchmark against which these clauses are assessed and, as a result, a damages clause that goes beyond compensation can now be valid.¹⁷

This reflects a more liberal approach to the contractual wishes of the parties and their possible reasons for agreeing to a damages clause that goes beyond compensation. Its effect is to give the courts greater flexibility and increase the prospects of damages clauses being enforced. This in turn gives the parties more scope to reinforce the protection of their contractual interests. They can tailor the level of protection to reflect their particular circumstances.

In both *Makdessi* and *Beavis*, the Supreme Court found that the injured party had a legitimate interest that justified a remedy going beyond compensation. *Makdessi* concerned two disputed clauses under which the buyer of a controlling interest in a business could withhold the final two instalments of the purchase price and acquire the sellers' shares at a price that excluded the value of its goodwill, if the sellers subsequently competed with the business. These clauses were not compensatory in nature and sought to deter breach yet they were held to be valid. The reason is that they were designed to protect the legitimate interest of the buyer in maintaining the goodwill of the business. This was essential to its value and the sellers' compliance was critical in preserving the goodwill.

In *Beavis*, the Supreme Court held that the management company of a car park had a legitimate interest in enforcing an £85 parking charge against a driver who had overstayed the two hour limit on parking. Although the fine was not compensatory and was designed to deter motorists from overstaying, the management company had a legitimate interest in the efficient use of the parking spaces for the benefit of other motorists, as well as in discharging its obligation to the owners of the car park and generating an income stream from the charges to meet its operating costs.

That contracting parties may have an interest in performance that goes beyond compensation had been accepted for some time before *Makdessi* in the default remedial regime. There was growing recognition in the case law and literature that parties enter into contracts for many reasons and that compensation is not always sufficient or adequate to protect their interests. It had been acknowledged for instance that parties can enter into a contract to obtain subjective and non-monetary gain and that loss is not always measurable in terms of market value.¹⁸ It had also been recognised that performance can have intrinsic value and an enforceable promise should confer on the injured party an entitlement to the promised performance, not simply an equivalent economic benefit.¹⁹

¹⁶ At [28]-[32], [99] per Lord Neuberger and Lord Sumption; [152] per Lord Mance; [255] per Lord Hodge.

¹⁷ *Ibid.*.

¹⁸ *Ruxley Electronics and Construction Ltd v Forstyh* [1996] A.C. 344 (HL); *Farley v Skinner* [2002] 2 A.C. 732 (HL); D. Harris, A. Ogus and J. Phillips "Contract Remedies and the Consumer Surplus" (1979) 95 L.Q.R. 581.

¹⁹ *Alfred McAlpine Construction Ltd v Panatown Ltd* [2001] 1 A.C. 518 (HL) per Lord Goff and Lord Millett.

This recognition that compensation does not always satisfactorily protect the contractual interests in play led to calls for the courts to grapple with the fundamental question of what constitutes loss and for remedies for breach of contract to be strengthened.²⁰ There has been a notable trend in the authorities towards the adoption of a broader approach to the concept of loss and increased protection of the performance interest. It is apparent for instance in the creation of exceptions to the general principle that non-pecuniary loss does not sound in damages,²¹ the suggestion that defeated expectations may amount to loss,²² and gain-based monetary awards being made.²³

In these contexts and with agreed damages clauses, a similar evolution is therefore discernible. Compensation remains the central remedial response and is considered to be satisfactory in most situations. However, where it fails to protect the wider contractual objectives of the parties, there is now acceptance that more robust protection of performance is appropriate. The distinguishing characteristic of damages clauses is that it is the parties themselves rather than the courts that identify this need. Since *Makdessi*, the courts will help them to meet the need and achieve better protection of performance by enforcing damages clauses more extensively and flexibly.

III. OTHER CONTEXTS WHERE “LEGITIMATE INTEREST IN PERFORMANCE” IS RELEVANT

When then will the injured party have an interest in performance which justifies the enforcement of a clause that goes beyond compensation? In laying down the new rule on penalties, the Supreme Court gave no clear answer to this question. It did however point, albeit in relatively general terms, to two other contexts, both concerning remedies for breach, in which a requirement of legitimate interest has been recognised. These are the line of cases that began with the well-known House of Lords decision on the right to affirm following a repudiatory breach, *White and Carter (Councils) Ltd v McGregor*,²⁴ and specific performance.²⁵ No mention was made of the other area of the law on remedies in which legitimate interest also plays a significant role, gain-based damages. However, following the same analogical reasoning, it is apt to consider whether there are parallels between the legitimate interest in that context and the requirement in the new test on penalties.

These areas of law will be considered in turn and the role of the legitimate interest in performance prior to *Makdessi* explained. It will be shown that the courts have had recourse to the requirement where compensatory damages have been inadequate to protect contractual expectations. In each of these areas, it has conferred on the courts a wide discretion, enabling them to be creative in granting relief, particularly in hard cases. Consideration will also be given to whether the requirement of a legitimate interest in performance in these contexts is the same as that in *Makdessi*.

²⁰ On the efficacy of the remedial system in protecting the performance interest, see E. McKendrick, “Breach of Contract and the Meaning of Loss” (1999) 52 C.L.P.; S. Rowan, *Remedies for Breach of Contract, A Comparative Analysis of the Protection of Performance* (Oxford 2012).

²¹ *Ruxley Electronics* [1996] A.C. 344 (HL); *Watts v Morrow* [1991] 1 W.L.R. 1421; *Farley v Skinner* [2002] 2 A.C. 732 (HL)

²² *Alfred McAlpine Construction Ltd v Panatown Ltd* [2001] 1 A.C. 518 (HL) per Lord Goff and Lord Millett.

²³ *A.G. v Blake* [2001] 1 A.C. 268 (HL) and see also the use of “negotiating damages”, also known as *Wrotham Park* damages.

²⁴ [1962] AC 413 (HL Sc).

²⁵ At [29] and [30] per Lord Neuberger and Lord Sumption.

A. The Right to Affirm After a Repudiatory Breach

Lord Neuberger and Lord Sumption said that *White and Carter*²⁶ supported the view that “the law will not generally make a remedy available to a party, the adverse impact of which on the defaulter significantly exceeds any legitimate interest of the innocent party”.²⁷ It is however questionable whether there are genuine parallels between the legitimate interests in *White and Carter* and *Makdessi*.

1. *White and Carter (Councils) Ltd v McGregor*

The concept of a “legitimate interest in performance” has had a role for more than 60 years where, following the defaulting party's repudiatory breach, the injured party seeks to affirm the contract, perform his remaining obligations and sue for the contract price. In the leading authority, *White and Carter*,²⁸ the sales manager of a garage entered into a contract with advertising agents for them to display its advertisements on street litter bins for a period of 3 years. Almost immediately after the contract had been concluded, the owner of the garage purported to cancel the contract, thereby repudiating it. The advertising agents declined to accept the repudiation, displayed the advertisements and sued the garage owner for the agreed price.

In the House of Lords, it was held by a majority of three to two that the advertising agents were not obliged to accept the repudiation and confined to recovering damages. They were entitled to the contract price. Lord Hodson, with whom Lord Tucker agreed, rested his decision on the principle that repudiation by one party does not itself discharge the contract and leave the other to his remedy in damages for breach. If there is no acceptance of the repudiation, the contract remains alive for the benefit of both parties. Lord Reid, while taking the same general view, suggested two possible limitations: first, performance by the injured party should not require the co-operation of the other party; second, he must have a legitimate interest in performing the contract rather than claiming damages. He said “...it may well be that, if it can be shown that a person has no legitimate interest, financial or otherwise, in performing the contract, rather than claiming damages, he ought not to be allowed to saddle the other party with an additional burden with no benefit to himself”.²⁹ Lord Reid therefore seemed to recognise that contracting parties can insist on performing their contractual obligations, albeit subject to these limitations.

White and Carter has been affirmed and Lord Reid's limitations applied in later cases. However, the courts have never satisfactorily unpacked the notion of “legitimate interest” in this context.³⁰ Lord Reid did not explain its meaning or origins and no clear definition or guidance has emerged in subsequent cases, although some further light has been shed on when a legitimate interest will arise. *The Aquafaitth*³¹ is a recent example. In that case, Cooke

²⁶ [1962] AC 413 (HL Sc).

²⁷ At [29] per Lord Neuberger and Lord Sumption.

²⁸ [1962] AC 413 (HL Sc).

²⁹ *Ibid.* at 431.

³⁰ Most recently see *MSC Mediterranean Shipping Co SA v Cottonex Anstalt* [2017] 2 All E.R. (Comm) (CA), [40] per Moore-Bick L.J.: “it may well be that the implications of Lord Reid's observations in *White & Carter* and the principles of law which underpin it have yet to be fully identified...”. See also the excellent article by Q. Liu, “The *White & Carter* Principle: A Restatement” 74 M.L.R. (2011) 171.

³¹ *Isabella Shipowner SA v Shagang Shipping Co Ltd (The “Aquafaitth”)* [2012] 1 C.L.C. 899. See also *Gator Shipping Corporation v Trans-Asiatic Oil Ltd (The “Odenfeld”)* [1978] 2 Lloyd's Rep 357 (QB) and *Ocean Marine Navigation Ltd v Koch Carbon Inc (The “Dynamic”)* [2003] EWHC 1936 (Comm.).

J held that the defaulting party has no legitimate interest in keeping the contract alive where damages are an adequate remedy and his insistence on performing is “wholly unreasonable”, a “commercial absurdity” or “perverse”.³² Whilst helpful to identifying whether there is a legitimate interest in rendering performance, this does not explain the notion and it remains uncertain when such an interest will be found to exist.

The exceptionality conveyed by the terms used in *The Aquafaitth*³³ suggests that the concept of legitimate interest in this context is narrow. In most circumstances, the injured party should be able to insist on performance and claim the agreed price. Performance is the rule and a finding that the injured party has no interest in performing will be rare.³⁴ It is not sufficient to show that he might mitigate his loss and claim damages for any shortfall or that he behaved unreasonably in the conventional sense of the term.³⁵ The degree of unreasonableness in his election to keep the contract alive must be severe for the courts to interfere.³⁶

Rare are the examples of attempts to keep a contract alive that have been found to be wholly unreasonable. Such examples as exist include where performance was economically futile or the sole aim was to generate a revenue stream. For instance, in *The Puerto Buitrago*,³⁷ the owners of a vessel could not keep a charterparty open until the charterers had fulfilled their repair obligations so as to recover hire that would accrue until the vessel was redelivered. This would be wholly unreasonable since the cost of repair was double the value of the ship when repaired and four times as much as its scrap value.³⁸ Similarly, in *MSC Mediterranean Shipping Co SA v Cottonex Anstalt*,³⁹ a carrier could not affirm a contract with a shipper to carry raw cotton under which the shipper had to return the containers to the carrier within 14 days of discharge from the vessel in circumstances where the carrier's only purpose in affirming was to claim ongoing demurrage from the shipper for the late return of the containers. Whilst clearly in default, the shipper was no longer able to return the containers and the commercial purpose of the venture had become frustrated.⁴⁰

2. Interest in obtaining performance v interest in performing

The Supreme Court's reliance on *White and Carter* to support a new legitimate interest requirement in the context of penalties was by no means obvious. *White and Carter* is itself controversial. It has been criticised for allowing the injured party to render performance that is no longer wanted by the defaulting party, seemingly contravening the duty to mitigate and

³² Ibid. at [44].

³³ [2012] 1 C.L.C. 899.

³⁴ Ibid. at [46]. *White and Carter* being a Scottish case, it is worth noting that it was followed by the First Division of the Court of Session in *Salaried Staff London Co v Swears & Wells* 1985 SC 185; however it has never been applied so as to prevent the injured party from keeping the contract alive, as illustrated by *AMA New Town Ltd v Law* 2013 SC 608.

³⁵ Ibid. at [42]. See also *Reichman v Beveridge* [2007] Bus L.R. 412 (CA)

³⁶ Ibid.

³⁷ *Attica Sea Carriers Corp v Ferrostaal Poseidon Bulk Reederei GmbH (The “Puerto Buitrago”)* [1976] 1 Lloyd's Rep 250 (CA).

³⁸ Ibid. at 255 per Lord Denning M.R..

³⁹ [2017] 2 All E.R. (Comm).

⁴⁰ Ibid. at [43], although Moore-Bick L.J. thought that this was not a case in which *White and Carter* applied since it was not open to the carrier to affirm the contract once the commercial purpose of the contract had become frustrated. He added however that, had this not been the case, “this is a classic case in which it would have been wholly unreasonable for the carrier to insist on further performance”.

leading to waste.⁴¹ The absence of any clear definition of legitimate interest in this context and the difficulty in articulating its meaning have also led to criticism. Lord Reid's qualification has been described as a "puzzle",⁴² "vague",⁴³ "unintelligible and elusive"⁴⁴ and suffering from "severe obscurity".⁴⁵ Some have argued that it should be abandoned altogether.⁴⁶

It is also unclear whether there is any real nexus between the legitimate interests in *White and Carter* and *Makdessi*. After all, *Makdessi* was concerned with a damages clause, which is a secondary obligation that provides for the consequences of breach⁴⁷ and is designed to protect the contractual expectations of the injured party in case of default. In that respect, it protects the injured party's interest in *obtaining* performance. In contrast, the legitimate interest of Lord Reid in *White and Carter* is concerned with the interest of the injured party in *rendering* performance, that is, in performing his own primary obligations under the contract. The key question is whether the injured party can insist on performing his side of the bargain. If so, his right to obtain the agreed sum is engaged, avoiding the need for him to resort to claiming damages.

This distinction between the interest in obtaining performance and the interest in rendering performance has rarely been articulated.⁴⁸ Only the former interest has been given any significant attention in the case law and literature. Nevertheless, it should be relatively uncontroversial that the party whose obligation under the contract is to deliver the goods, services or other consideration may himself wish to insist on rendering that performance. The reasons are numerous and not confined to obtaining the contract price. The protection or enhancement of his reputation and honouring commitments made to third parties are just some examples.

That the two interests are different is also evident from the injured party almost always being considered to have a legitimate interest in performing his own obligations following the counterparty's repudiation but only exceptionally having a legitimate interest in the counterparty's performance that goes beyond compensation following a breach (of any kind). The injured party is assumed to have an interest in maintaining the contract rather than

⁴¹ A. Burrows, *Remedies for Torts and Breach of Contract*, 3rd edn (Oxford 2004) 440; S. Stoljar, "Some Problems of Anticipatory Breach" (1974) 9 *Melb. U. L. Rev.* 355.

⁴² J.W. Carter, "White and Carter v McGregor – How Unreasonable?" (2012) 128 *L.Q.R.* 490, at p.491.

⁴³ *Ibid.*.

⁴⁴ Liu, "The *White & Carter* Principle" at p.171.

⁴⁵ *Ibid.*.

⁴⁶ J. O'Sullivan, "Repudiation: Keeping the Contract Alive" in G. Virgo and S. Worthington (eds.), *Commercial Remedies: Resolving Controversies* (Cambridge 2017), 51 who argues that the injured party should always be permitted to honour and perform to obtain the promised consideration subject to the policy concern to avoid stalemate and perpetual obligations. J. Morgan, "Smuggling Mitigation into *White & Carter v McGregor*: Time to Come Clean?" (2015) 4 *LMCLQ* 575 argues in favour of a general mitigation qualification on the right to elect to maintain performance. See however M P Gergen, "The Right to Perform after Repudiation and Recover the Contract Price in Anglo-American Law", in L A DiMatteo and M Hogg (eds), *Comparative Contract Law: British and American Perspectives* (2015) 314, who is supportive of the legitimate interest test and seeks to articulate its objectives, in particular the avoidance of possible uncompensated loss for the injured party. The Scottish Law Commission in its *Report on Review of Contract Law* No 250 (2018), Chap 12, made no recommendation on direct reform of the law in this area and instead encouraged the Scottish courts to develop the legitimate interest test when the opportunity arises.

⁴⁷ [2016] A.C. 172 at [32] per Lord Neuberger and Lord Sumption; [241] per Lord Hodge.

⁴⁸ It is however addressed in Liu, "The *White & Carter* Principle", S. Whittaker, "Performance of Another's Obligation: French and English Law Contrasted" in D. Johnston and R. Zimmerman (eds.), *Unjustified Unrichment: Key Issues in Comparative Perspective* (Cambridge 2001) 433, and Rowan. "Remedies for Breach of Contract".

claiming damages in the *White and Carter* context. It is for the defaulting party to demonstrate to the contrary and the threshold is a high one.⁴⁹ In contrast, the injured party will have an interest in obtaining performance rather than compensation only exceptionally, as is clear in the context of specific performance and gain-based awards. The same seems also to be true in the context of damages clauses, as is illustrated by the statement of Lord Neuberger and Lord Sumption that, with straightforward damages clauses, the legitimate interest will rarely extend beyond compensation for the breach.⁵⁰ Whilst the interest in performing is strong, the interest in obtaining performance is weak. Their reference to Lord Reid's qualification therefore seems incongruous.

The only parallels that can be drawn between the two contexts are at a relatively high level. One is that, at the heart of both legitimate interests is the performance of the contract and the protection of the injured party who wants performance to occur. In *White and Carter*, this was the party who wished to perform his obligations so as to earn the contract price.⁵¹ With damages clauses, it is the beneficiary of the promise to perform that is seeking to obtain the promised performance.

Another parallel is that in both contexts the court must determine whether compensation is an adequate remedial response to which the injured party should be confined. In the context of *White and Carter*, the question is whether the injured party can perform in order to obtain the contract price and not merely compensation.⁵² With damages clauses, it is whether the parties can agree to a remedy that goes beyond compensation.

That the legitimate interests in performance in these two contexts are different and also the significance of the difference casts doubt on the parallels drawn between them by the Supreme Court. The use of the same or similar terms in the two contexts should not simply be assumed to mean that the concepts can be equated. This is not to say that the legitimate interest in *White and Carter* should be ignored completely, particularly in the absence of any satisfactory explanation of the test in either context and as the courts continue to find their way in how both tests operate. They share some high level commonalities. However, it is important that any perceived parallels are scrutinised carefully and not simply accepted as correct on the basis of a premise that is superficially attractive but on close examination turns out to be substantively false or at best doubtful.

B. Specific Performance

Specific performance was also cited by Lord Neuberger and Lord Sumption in support of a legitimate interest in performance in the new test on penalties as a context in which the courts require before granting relief that the injured party has a legitimate interest in performance that goes beyond compensation. They said that “the minimum condition for an order for specific performance is that the innocent party should have a legitimate interest extending beyond pecuniary compensation for the breach”.⁵³ This condition is imposed because specific performance protects the performance interest to a much greater extent than

⁴⁹ *The “Aquafaitth”* [2012] 1 C.L.C. 899 at [48]-[50] per Cooke J..

⁵⁰ At [32] per Lord Neuberger and Lord Sumption.

⁵¹ Liu, “The *White & Carter* Principle”.

⁵² *MSC Mediterranean Shipping Co SA v Cottonex Anstalt* [2017] 2 All E.R. (Comm) (CA), [40] per Moore-Bick L.J..

⁵³ At [29] and [30].

compensation.⁵⁴ The primary obligations of the defaulting party are enforced directly in that he is compelled to fulfil them.

The requirement of a legitimate interest in performance does not have the status of being part of the test for specific performance, as appears now to be the case for penalty clauses. Nevertheless, an injured party preferring performance to damages as a remedy must show that he has an interest in obtaining the very thing that he was promised as opposed to a substitute which a monetary award would allow him to buy.⁵⁵ The most important hurdle to obtaining specific performance is that damages must be inadequate.⁵⁶ This will depend to a large extent upon whether a substitute for the promised performance is obtainable in the market. Where the injured party is able to buy a satisfactory replacement, his expectations are deemed to be fulfilled by damages. In contrast, where a substitute is unavailable, damages are considered to be inadequate. In these instances, the injured party has an interest in performance that justifies a remedy that goes beyond compensation.

The requirement that damages be inadequate therefore operates to isolate the cases in which specific performance is more appropriate as a remedy than compensation. Frequently cited examples and indeed two of the few instances where specific performance is routinely awarded are contracts for the sale of land and contracts for the sale of unique goods. Each plot of land is considered to be unique and irreplaceable. As a result, damages for breach of such contracts will seldom be adequate. The buyer's interest is not in obtaining compensation, which is ineffective to protect his contractual expectations; it is in obtaining performance itself.

It is more readily apparent why Lord Neuberger and Lord Sumption sought to draw support from specific performance than *White and Carter*. There are parallels between the legitimate interest requirements in the contexts of damages clauses and specific performance. The injured party must show that he has an interest in receiving what he contracted for. It enables the court to determine which remedy best fulfils his contractual expectations and, in particular, whether compensation is sufficient to protect these expectations. If not, then a remedial response that is non-compensatory and more robust is justified.

Another parallel is that the injured party is only rarely considered to have a legitimate interest in performance that goes beyond compensation in the two contexts. Confining specific performance to cases where damages are inadequate has the effect that the remedy is seldom available. It makes no difference that the injured party subjectively prefers performance over damages. In common with this, it will be unusual that a damages clause is found to protect an interest in performance that goes beyond compensation. This is clear from Lord Neuberger and Lord Sumption's statement that the interest of the injured party will rarely extend beyond compensation for breach.⁵⁷

As a result and as with specific performance, a legitimate interest that justifies a damages clause going beyond compensation will be rare in regular commercial contracts. Where compensatory damages can buy a satisfactory replacement for the bargained-for advantage, for instance where the subject-matter of the contract is a marketable commodity for which there is a readily obtainable substitute, damages clauses that over-compensate and seek to deter breach are unlikely to be justifiable. Conversely, there is greater scope for

⁵⁴ D. Harris "Incentives to Perform or Break Contracts" (1992) 45(2) CLP 29, 30.

⁵⁵ G. Treitel, *Remedies for Breach of Contract: A Comparative Account* (Oxford 1976) at [63]ff.

⁵⁶ *Co-operative Insurance Society Ltd v Argyll Stores (Holdings) Ltd* [1998] A.C. 1 (HL) 11 per Lord Hoffmann.

⁵⁷ At [29] and [30].

justifying a damages clause that departs from the compensatory measure in contracts for the sale of unique goods or the sale of land.⁵⁸ Since no substitute is available, a compensatory damages clause is less likely to satisfy the interest in performance of the injured party.

However, the analogy between the two contexts has its limits. There are intrinsic differences between the two remedies which may impact on how the legitimate interest requirement operates. Specific performance is coercive and draconian in nature, compelling the defaulting party to perform. It is not available where there would be a risk of involuntary servitude for the defaulting party, which explains why it is not ordered to enforce personal service contracts.⁵⁹ Similarly, for obligations to render a service, the unpalatable possibility of a specific performance order requiring constant court supervision usually means that the remedy is unavailable. This objection is particularly prominent in the context of building contracts.⁶⁰ In contrast, damages clauses require only the payment of money, which is less likely to give rise to these issues. Therefore, while the injured party's interest in receiving what he contracted for may be defeated in claims for specific performance of obligations that are personal in nature or require constant supervision, these objections are unlikely to be fatal to a damages clause and the recognition that there is a legitimate interest in performance that justifies another remedial response than compensation.⁶¹

C. Gain-Based Damages

Although not referred to in *Makdessi*, the legitimate interest in obtaining performance has also played a significant role in the context of restitutionary monetary awards. In the well-known case of *Attorney General v Blake*,⁶² a majority of the House of Lords invoked the discretionary remedy of an account of profits to order the disgorgement of gains made by a spy from the publication of information that he had agreed with the Crown to keep secret. Lord Nicholls, giving the leading judgment, said:

An award of damages ... is not always 'adequate' as a remedy ... The law recognises that a party to a contract may have an interest in performance which is not readily measurable in terms of money ... [T]he plaintiff's interest in performance may make it just and equitable that the defendant should retain no benefit from his breach of contract ... An account of profits will be appropriate in exceptional circumstances ... A useful guide ... is whether the plaintiff had a legitimate interest in preventing the defendant's profit-making activity and, hence, in depriving him of his profit.⁶³

The pre-conditions to an account of profits being awarded are that other remedies for breach of contract are inadequate and the injured party has a legitimate interest in depriving the defaulting party of his profit. On the facts, other remedies were unavailable and the majority of the House of Lords also held that the Crown had a legitimate interest in preventing Blake from profiting. This was to ensure that there were no financial incentives for other members

⁵⁸ Beale, *Chitty on Contracts*, at [26-201].

⁵⁹ *De Francesco v Barnum* (1890) 45 Ch D 430; *R v Incorporated Froebel Educational Institute Ex p L* [199] E.L.R. 488 (QB).

⁶⁰ E.g. *Flint v Brandon* (1803) 8 Ves 159.

⁶¹ Beale, *Chitty on Contracts*, [26-201].

⁶² *A.G. v Blake* [2001] 1 A.C. 268 (HL).

⁶³ *Ibid.* at pp.282 and 285.

of the intelligence service to reveal information in a similar way, lest morale and trust between members of the service be undermined.

The legitimate interest in *Blake* has been controversial and criticised as “uncertain” and “open-ended”⁶⁴ and as importing a wide degree of judicial discretion.⁶⁵ The House of Lords said very little on its meaning, instead explaining that it would be “difficult, and unwise, to attempt to be more specific”.⁶⁶ In the words of Lord Steyn, the circumstances in which disgorgement of profits should be ordered are ‘best hammered out on the anvil of concrete cases’.⁶⁷ It might be because of these uncertainties that the Supreme Court did not refer to the remedy in *Makdessi*.

Another possible reason is that a legitimate interest in performance that justifies disgorgement has rarely been made out in later cases and there has been little further judicial guidance on the scope of the remedy. Unsurprisingly, the lower courts have shown no inclination to explore an issue that the House of Lords openly avoided.

One case in which *Blake* was applied is *Esso Petroleum Co Ltd v Niad Ltd*.⁶⁸ A petrol station owner breached an obligation to abide by recommended retail prices set by its fuel supplier, Esso, in return for financial support from Esso, which was operating a price-matching scheme that aimed to undercut or compete with the prices of competitors. He did so by charging higher prices to customers. Insurmountable difficulties in attributing lost sales to the breach meant that compensatory damages were “almost impossible”⁶⁹ to assess. As the breach was repeated and fundamentally undermined the whole price-matching scheme, the fuel supplier had a legitimate interest in enforcing the scheme and preventing the petrol station owner from profiting and was therefore entitled to an account of profits.

Following *Blake* and until very recently, the legitimate interest in depriving the defaulting party of his profits also featured in the court's reasoning when awarding “negotiating damages”,⁷⁰ more commonly known as *Wrotham Park* damages.⁷¹ This measure of damages compensates the injured party for the hypothetical price that he would have been willing to accept to release the defaulting party from the obligation that was breached and in many cases has been assessed as a proportion of the defaulting party's profits from the breach.

However, any requirement of a legitimate interest to claim negotiating damages was rejected by the Supreme Court in *Morris Garner v One Step (Support) Ltd*⁷² which, like *Makdessi*, involved the breach of non-compete covenants. Instead, the court held that negotiating damages are compensatory in nature and available “where the loss suffered by the claimant is appropriately measured by reference to the economic value of the right which has been breached”.⁷³ As such, no question arises as to whether or not there is a legitimate interest in preventing the profit-making activity of the defaulting party.⁷⁴ “Legitimate

⁶⁴ Burrows, “*Remedies for Torts and Breach of Contract*”, 403.

⁶⁵ Ibid; D. Campbell and P Wylie, “Ain’t no Telling (Which Circumstances are Exceptional)” (2003) 62 C.L.J. 605; R. Ahdar, “Contract Doctrine, Predictability and the Nebulous Exception” (2014) 73 C.L.J. 39.

⁶⁶ [2001] 1 A.C. 268 (HL) at 285 per Lord Nicholls.

⁶⁷ [2001] 1 A.C. 268 (HL) at 291 per Lord Steyn.

⁶⁸ [2001] All E.R. (D) 324 (Ch).

⁶⁹ Ibid. at [63] per Morritt V.C..

⁷⁰ This term was preferred by the Supreme Court to “*Wrotham Park* damages” in *Morris Garner v One Step (Support) Ltd* [2018] UKSC 20.

⁷¹ *Experience Hendrix LLC v PPX Enterprises Inc* [2003] EWCA Civ 323 (CA).

⁷² [2018] UKSC 20.

⁷³ Ibid. at [91] per Lord Reed.

⁷⁴ Ibid. at [90] and [97] per Lord Reed.

interest” was therefore rejected in *One Step* soon after being given new prominence in *Makdessi*. Yet in both cases the Supreme Court was confronted with the same fundamental issue of what constitutes loss and was pursuing the same objective of protecting goodwill.⁷⁵

Despite *One Step* and indeed the absence of any reference in *Makdessi* to *Blake*, it is possible to draw broader parallels between the legitimate interest in performance that hitherto applied in this context and its new incarnation in relation to damages clauses. First, there are similarities in the nature and function of the requirement. In both contexts, the legitimate interest is that of the injured party and it is in obtaining performance of the promise made to him (as is also the case in the context of specific performance). The court seeks to establish whether there is a legitimate interest in the injured party obtaining a remedy beyond the normal compensatory measure. Only where this measure is warranted in order to protect his contractual expectations fully can the normal measure be departed from.

Second, in both contexts, deterring breach and more generally influencing behaviour are legitimate objectives. The prospect of being stripped of profit disincentivises breach and encourages performance, as do over-compensatory damages clauses. In the context of disgorgement, this is achieved by depriving the defaulting party of gains that result from his breach.⁷⁶ With damages clauses, it is the threat of the defaulting party having to make a large payment on breach. In both contexts, the deterrent effect is justifiable where, to use the words of Lord Neuberger and Lord Sumption in *Makdessi*, “there is a legitimate interest in influencing the conduct of the contracting party which is not satisfied by the mere right to recover damages for breach”.⁷⁷ These parallels suggest that, as with specific performance, the Supreme Court in *Makdessi* might have drawn support from the legitimate interest requirement in *Blake*.

IV. CONSIDERATIONS RELEVANT TO THE “LEGITIMATE INTEREST IN PERFORMANCE”

If the injured party’s entitlement to rely on a damages clause that goes beyond compensation is to turn on the extent of his legitimate interest in performance, the court needs tools to measure this interest in each case. Some guidance can be drawn from the Supreme Court’s reasoning on the facts of *Makdessi* and *Beavis* in deciding that there was a legitimate interest going beyond compensation in those cases. The link drawn by Lord Neuberger and Lord Sumption with the legitimate interest in *White and Carter* and specific performance and its relevance in respect of gain-based damages are also potentially fruitful sources of guidance. Whilst the primary purpose of this link appears to have been to justify the introduction of the new requirement for damages clauses, it was shown in the previous section of this article that there are clear parallels between the new requirement and the legitimate interest applied in these contexts, particularly specific performance and gain-based damages. The most important, and seemingly an essential pre-condition in each case, is that compensation is inadequate to fulfil the contractual expectations of the injured party such that a more robust remedial response is needed. These parallels raise the prospect that the considerations taken into account by the courts to determine when such a remedy is appropriate may also be relevant in the context of damages clauses and capable of informing when there will be a

⁷⁵ See section I.B. on this issue.

⁷⁶ J. Edelman “Profits and Gains from Breach of Contract” [2001] L.M.C.L.Q. 9.

⁷⁷ At [99].

legitimate interest in performance that justifies a damages clause that goes beyond compensation.

This section of the article is concerned with identifying and exploring the considerations that have the greatest potential to be relevant to the legitimate interest test for agreed damages clauses. These can be divined from *Makdessi* itself, some post-*Makdessi* cases, and also the case law in these other contexts. It is submitted that they are the importance of the term broken and the seriousness of the consequences of the breach on the injured party, the impact of breach on the interests of third parties, the protection of the public interest, the protection of non-financial expectations, and the presence or absence of certain characteristics in the parties.

A. The Importance of the Obligation and the Seriousness of the Consequences of Breach

Two linked considerations that seem likely to be relevant to establishing a legitimate interest in performance that goes beyond compensation in respect of damages clauses are whether the obligation to which the clause attaches is of essential importance and the seriousness of the consequences of its breach. Where the obligation goes directly to the root of the contract or is essential to its working and objectives and breach would deprive the injured party of substantially the whole benefit that he intended to obtain, this can be expected to militate in favour of a finding that there is such an interest. The more important is the obligation breached and the more serious are the consequences of the breach for the injured party, the more likely there will be an interest in obtaining and encouraging performance. These considerations should be assessed at the time that the contract was made.⁷⁸

Both considerations were relied upon in *Makdessi* itself and have also featured in other areas of the law of remedies. In *Makdessi*, the Supreme Court emphasised that the disputed non-compete covenants had been inserted so as to ensure the loyalty of the sellers and protect the goodwill of the business, which were at the very heart of the contract and critically important to the buyer. A significant proportion of the contract price was attributable to them⁷⁹ since the value of the business was founded mainly on its goodwill, without which it would be worth much less.⁸⁰ Breach of the covenants would have an impact on the whole business and be severely detrimental to its value, and would defeat the buyer's commercial objectives in acquiring the business.⁸¹ The buyer therefore had a legitimate interest in maintaining the goodwill.

The Supreme Court in *Makdessi* also placed weight on these considerations when analysing the seminal authority on penalty clauses, *Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd*.⁸² In this well-known case, dealers in motor accessories had agreed, as part of a retail price maintenance scheme, not to sell tyres below a tyre manufacturers' list price. The contract provided that the dealers would have to pay the manufacturers £5 for every tyre sold in breach of the undertaking. This was held by the House of Lords to be liquidated damages and therefore enforceable, rather than an unenforceable penalty, on the grounds that the loss likely to result from breach was difficult to assess and £5 was a genuine attempt to estimate loss.

⁷⁸ At [9], [87] Lord Neuberger and Lord Sumption; [243], [281] Lord Hodge; and [294] Lord Toulson.

⁷⁹ At [273]-[274] per Lord Hodge.

⁸⁰ At [75] Lord Neuberger and Lord Sumption.

⁸¹ At [180]-[181] per Lord Mance.

⁸² [1915] AC 847.

The Supreme Court concurred with the reasoning of Lord Atkinson in *Dunlop*,⁸³ which emphasised that the manufacturers had a wider interest in enforcing the damages clause than pecuniary compensation. This was in preventing the prices that they had set from being undercut and maintaining their trading system, which could only achieve its objectives if all of the trading partners adhered to it and charged the same prices for tyres. Breach would seriously undermine their trading system and injure their business. The disputed clause, which sought to guard against these consequences and in doing so protect their brand, reputation and goodwill and their authorised distribution network was therefore acceptable.⁸⁴

The importance of the obligation to which the clause relates and the seriousness of the consequences of the breach have also been taken into account in relation to the enforceability of a damages clause in the cases that have followed *Makdessi*. In the Scottish case of *Gray v Braid Group (Holdings) Ltd*,⁸⁵ for instance, an employee and director who was also a shareholder in the company had been dismissed for his involvement in two instances of bribery in connection with his work. The disputed term was a “bad leaver” provision in the company's Articles of Association, which provided that a shareholder employee or director who commits an act of gross misconduct or persistently underperforms should transfer his shares at subscription price. There was a large discrepancy between the current fair value of the dismissed employee’s shares and the subscription price. The issue was whether the bad leaver provision was penal.

A majority of the Court of Session held that the provision was valid. The company had a legitimate interest in the faithful and diligent performance by its shareholders of their duties as employees and/or directors and the secondary obligation was not exorbitant despite the large discrepancy between the current fair value and the subscription price of the shares. In assessing whether there was a legitimate interest in performance, the court considered that it was essential for the company that employees and directors performed their duties properly and that fraud and gross misconduct was deterred. Fraudulent conduct by shareholder employee or director could be and on the facts had been highly damaging to the injured party, both financially and also to the reputation of its business.⁸⁶

In the same vein, in *Vivienne Westwood Ltd v Conduit Street Development Ltd*,⁸⁷ another post-*Makdessi* case, the possibility that no serious consequences would result from the breach was a factor in the court's decision that there was no legitimate interest in performance going beyond compensation. The landlord and tenant of retail shop premises had agreed in a side letter to the lease to a reduction in the rent payable under the lease. If the tenant defaulted in any way, the landlord could terminate the side letter and the rent payable would revert back to its original level. As a result of some confusion, the tenant failed to make a monthly rent payment. When the landlord purported to terminate the side letter, the question arose as to whether its right to terminate upon any breach of the contract was penal and therefore unenforceable.

The court recognised that the landlord had a financial interest in having a performing rather than a defaulting tenant. Moreover, this was capable of impacting on the value of its reversion in a way that might extend beyond cash flow benefits and financial compensation for delayed performance. However, this was only likely in cases of serious breaches of

⁸³ *Ibid.*.

⁸⁴ At [22]-[23] per Lord Neuberger and Lord Sumption; [152] per Lord Mance; [221] per Lord Hope.

⁸⁵ [2016] CSIH 68 (Court of Session Scotland).

⁸⁶ *Ibid* at [125].

⁸⁷ [2017] EWHC 350 (Ch.).

contract. Where the breaches were minor or the consequences of non-performance of little significance, uncompensated loss was unlikely to follow. The disputed clause was held to be a penalty.⁸⁸

That the importance of the term breached and the extent of the resulting loss are likely to be relevant considerations is reinforced by the weight given to these factors by the courts in the context of specific performance and gain-based damages. For instance, when considering whether or not to grant specific performance, the courts have shown willingness to take into account that the breach of contract, if remedied merely by damages, would cause serious disruption to the injured party's business and might even lead to its insolvency. This point was made clearly by Megarry V-C in *Howard Perry Ltd v British Railways Board*,⁸⁹ a case in which a strike made steel almost unobtainable, and steel stockholders sought a court order releasing steel that they owned but which was held unlawfully by a rail carrier. In ordering delivery of the steel, he said:

[I]t can be said that as those who trade do so for profit, damages of a sufficient amount may compensate for any wrong. All that the plaintiffs are losing...is the sale of some steel, and damages will adequately compensate them for that. I do not think that this is by any means the whole picture. Damages would be a poor consolation if the failure of supplies forces a trader to lay off staff and disappoint his customers (whose affections may be transferred to others) and ultimately impels him towards insolvency.⁹⁰

The potential relevance of serious business disruption or the risk of insolvency is also illustrated by *Sky Petroleum Ltd v VIP Petroleum Ltd*,⁹¹ in which the 1970s oil crisis had restricted the supply of petrol. Goulding J granted an interim injunction which had the effect of requiring specific performance of a contract to supply petrol. As the defaulting petrol supplier was the only available source of petrol, the injured petrol retailer was dependent on it performing the contract for the survival of its business.

In the context of gain-based damages, the importance of the term breached and the consequences of the breach are also considerations relevant to whether there is a legitimate interest in performance that goes beyond compensation. When deciding whether the Crown had a legitimate interest in preventing Blake from profiting, the House of Lords took into account that an absolute rule against disclosure by members of the secret service was critically important to the effectiveness of the secret service. Its breach would put this in jeopardy by undermining the willingness of prospective informers to co-operate and the trust between members of the secret service engaged in dangerous activities.⁹² It would also cause "immeasurable damage" to the public interest.⁹³

Similarly, in *Esso Petroleum Co Ltd v Niad Ltd*,⁹⁴ another case in which an account of profits was awarded, these considerations were relevant to the determination that the fuel supplier had a legitimate interest in preventing the petrol station owner from charging higher

⁸⁸ At [50]-[53] and [60].

⁸⁹ [1980] 1 W.L.R. 1375 (Ch.).

⁹⁰ *Ibid.* at 1383.

⁹¹ [1974] 1 W.L.R. 576 (Ch.).

⁹² [2001] 1 A.C. 268 (HL) at 287 per Lord Nicholls.

⁹³ *Ibid.* at 286 per Lord Nicholls.

⁹⁴ [2001] All E.R. (D) 324 (Ch.)

prices to customers in breach of an obligation to abide by the fuel supplier's recommended retail prices. This obligation was entered into in return for financial support from the fuel supplier and was essential to the fuel supplier's price-matching scheme, which would be undermined by the petrol station owner's breach.

B. The Impact of Breach on the Interests of Third Parties

Another consideration that is likely to be relevant to whether there is a legitimate interest in performance that goes beyond compensation is the impact that breach or performance would have on third parties. This was taken into account by the Supreme Court in *Beavis* in support of its finding that there was a legitimate interest going beyond compensation in that case. The third parties concerned were the owners of the land where the carpark was located. Both the £85 charge and more generally the carparking scheme that ParkingEye operated were held to serve the interests of the landowners as well as those of ParkingEye. This was because the landowners received a fee from ParkingEye for the right to manage the car park and also enabled them to lease sites to retailers for which a car park is a valuable facility.⁹⁵

The impact of breach on others is likely to be particularly significant where the third party cannot obtain a remedy in its own right. When awarding compensatory damages where there is no damages clause, the courts have taken account of the impact of breach on and the resulting losses for third parties where, because there is no privity of contract, they are unable to sue for breach and are deprived of a remedy. In some circumstances,⁹⁶ the promisee, despite not suffering the loss, has been allowed to enforce contractual rights against the defaulting party on behalf of the third party.⁹⁷ This has enabled the promisee to obtain damages for the losses suffered by the third party, but subject to an obligation to account to the third party. It can be expected that where the promisee provides for this same result through a damages clause, a legitimate interest will be found. The interest will be in providing the third party with compensation and preventing the defaulting party from escaping liability where the loss resulting from breach happens to fall elsewhere than on the promisee.⁹⁸

The implications for third parties has also been held to be a relevant factor in the other contexts referred to by the Supreme Court in *Makdessi*, specific performance and the *White and Carter* scenario. Its potential relevance to specific performance is illustrated by *Beswick v Beswick*.⁹⁹ Peter Beswick agreed to sell his business to his nephew in return for payments to his wife of £5 after his death. In breach of contract the nephew refused to pay the weekly annuity when his uncle died. The House of Lords held that the widow, acting as her husband's administratrix, could obtain specific performance of the obligation. Justice required that she should have a meaningful remedy. Whilst as a third party to the agreement between her husband and her nephew she could not obtain more than nominal damages, the defaulting nephew had received all the consideration under the contract without paying the price for it,

⁹⁵ At [99] per Lord Neuberger and Lord Sumption; [193] per Lord Mance; [286] per Lord Hodge.

⁹⁶ *Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd* (consolidated with *St Martins Property Corp Ltd v Sir Robert McAlpine Ltd* [1994] 1 AC 85 (HL)); *Alfred McAlpine Construction Ltd v Panatown Ltd* [2001] 1 A.C. 518 (HL).

⁹⁷ Otherwise known as the problem of “transferred loss”.

⁹⁸ On this point, see the Scottish Law Commission’s *Report on Review of Contract Law: Formation, Interpretation, Remedies for Breach of Contract, and Penalty Clauses* No 252 (2018) at para. 20-21.

⁹⁹ [1966] A.C. 58 (HL).

he owed a continuing obligation her, and the husband could have obtained specific performance.

Similarly, in the *White and Carter* line of cases, if a third party would be negatively affected by the injured party being disabled from performing his obligations under the contract, this militates in favour of allowing him to perform rather than limiting him to a damages claim. An example can be found in *Anglo-African Shipping Co v Mortner*.¹⁰⁰ The injured party had contracted to act as a confirming house and shipping agent in respect of an order for the purchase of goods made by the defaulting party with a third party supplier. In return, the defaulting party agreed to reimburse the injured party the purchase price and its expenses and make a commission payment. After the injured party had purchased and taken delivery of the goods from the supplier, the defaulting party repudiated the contract and refused to make any payment. The injured party nevertheless proceeded to deliver the goods to the defaulting party and sued for payment. Megaw J held that the injured party could recover the price of the goods, its expenses and the commission. He took into account that, if the injured party was prevented from performing its side of the contract and forced to accept the defaulting party's repudiation, this would have negatively affected third parties in that it would have led to the cancellation of sub-contracts. This was also a consideration in *The Odenfeld*.¹⁰¹ The fact that the owners of the vessel had an obligation to third parties, who were "entirely innocent",¹⁰² to keep the charterparty in existence meant that they were not acting unreasonably in refusing the repudiation.

C. The Relevance of the Public Interest

The courts have even taken account of wider societal interests as either militating in favour of or against a conclusion that the injured party has a legitimate interest in obtaining performance rather than compensation. In *Beavis*, the Supreme Court found that the £85 charge to deter motorists from overstaying beyond the 2 free hours of parking served the public interest, in that consumers and retailers benefited from having free parking for a limited period. It deterred commuters from occupying parking spaces for long periods and allowed ParkingEye to manage the use of the spaces efficiently.¹⁰³

The desirability of taking societal interests into account when determining the validity of privately negotiated contract clauses has been questioned¹⁰⁴ but is not without precedent. An example is restraint of trade clauses, which are enforceable only if reasonable with reference to the interests of the parties and not contrary to the public interest.¹⁰⁵ The courts take account of the impact of the limitation of liberty to trade imposed by the clause upon the general welfare.¹⁰⁶ This is said to require that "everyone should be free so far as practicable to earn a livelihood and to give to the public the fruits of his particular abilities".¹⁰⁷

¹⁰⁰ [1962] 1 Lloyd's Rep 81 (QB).

¹⁰¹ *Gator Shipping Corporation v Trans-Asiatic Oil Ltd (The "Odenfeld")* [1978] 2 Lloyd's Rep 357 (QB).

¹⁰² *Ibid.* at 374.

¹⁰³ [98] See also *Lordsvale Finance plc v Bank of Zambia* [1996] Q.B. 752 in which Colman J. referred to the "great disservice to international banking" if the clause was not enforced

¹⁰⁴ Summers "Unresolved Issues" at pp. 217-218.

¹⁰⁵ Beale, *Chitty on Contracts*, at [16-106].

¹⁰⁶ Beale, *Chitty on Contracts*, at [16-085].

¹⁰⁷ *Schroeder Music Publishing Co v Macaulay* [1974] 1 WLR 1308, 1313 (Lord Reid).

The public interest has also long been a relevant consideration in the context of specific relief. In *Wrotham Park Estate Co Ltd v Parkside Homes Ltd*,¹⁰⁸ for instance, an order requiring the demolition of a housing estate built in breach of a restrictive covenant was refused. The owner of the dominant tenement could show no loss and the demolition of the houses was unnecessary to preserve the integrity of the restrictive covenant. Brightman J also reasoned that to grant a mandatory order which required the demolition would amount to “an unpardonable waste of much needed houses”.¹⁰⁹ Similarly, in *Co-operative v Argyll*,¹¹⁰ the House of Lords refused to order specific performance of a covenant in a 35-year lease which required a supermarket that was operating at a loss to be kept open for retail business. A factor that influenced this conclusion was that the public interest could not be served by requiring that a business be carried on at a loss if there was a plausible alternative way of compensating the injured party.¹¹¹

Public interest considerations were also very obviously relevant in *AG v Blake*,¹¹² where national security was at stake. The Crown had to remove any financial incentives for members of the intelligence service to disclose confidential information in order to protect public safety.

D. The Protection of Non-Financial Expectations

Another factor likely to be relevant in determining whether the injured party has an interest in performance that goes beyond compensation is that the interest sought to be protected is non-financial in nature.¹¹³ Compensation for non-pecuniary loss such as loss of reputation, frustration, and distress is heavily circumscribed in English law.¹¹⁴ A frequently cited reason is that non-pecuniary loss is difficult to identify and prove and not readily susceptible to accurate and consistent measurement.¹¹⁵ Damages are therefore often unavailable. So as to redress this deficiency and provide a remedy that nonetheless protects the expectations of the injured party, the courts have at times devised creative solutions.

This is illustrated by *AG v Blake*.¹¹⁶ A factor that weighed in favour of the finding that the Crown had a legitimate interest in deterring breach and the award of gain-based damages was that the contracted-for benefit, that is, confidentiality, did not have a financial or market value. Since no recognised compensable loss had been suffered, compensatory damages were unavailable. An award of nominal damages was regarded as tantamount to costless permission to breach which, in practical terms, would render the confidentiality obligations unenforceable. Such an undesirable outcome was avoided by resorting to the gain-based remedy of an account of profits.¹¹⁷

That the protected interest is non-financial has also been found to be relevant in the *White & Carter* context. In *Ministry of Sound (Ireland) Ltd v World Online Ltd*,¹¹⁸ an internet

¹⁰⁸ [1974] 1 WLR 798 (Ch).

¹⁰⁹ *Ibid.* 811.

¹¹⁰ [1998] A.C. 1 (HL).

¹¹¹ *Ibid.* at 15 (Lord Hoffmann).

¹¹² [2001] 1 A.C. 268 (HL).

¹¹³ An example of a case in which an over-compensatory damages clause was upheld even though the injured party had suffered no financial loss is *Clydebank Engineering Co v Castaneda* [1905] AC 6.

¹¹⁴ *Addis v Gramophone* [1909] AC 48 (HL).

¹¹⁵ *Farley v Skinner* [2000] P.L.N.R. 441 (CA) 454 (Mummery L.J.).

¹¹⁶ [2001] 1 A.C. 268 (HL).

¹¹⁷ *Ibid.* at 284 and 287 per Lord Nicholls; 292 per Lord Steyn.

¹¹⁸ [2003] 2 All E.R. 823.

service provider entered into a contract for the distribution of compact discs and the provision of internet services with a group of companies operating nightclubs with whose brand it wished to be associated. It later repudiated the contract and refused to pay the last instalment due under a contract. In holding that the group of companies had an interest in the contract continuing such that they could continue to perform and obtain payment, the court had regard to the fact that they wanted to maintain the contract for non-financial reasons. The name of the nightclub business had become associated with the service provided by the repudiating internet service provider and the premature termination of this service would have been detrimental to them.¹¹⁹

That a damages clause which protects a non-financial interest is likely to be enforceable is also evident from the post-*Makdessi* case of *Gray*,¹²⁰ which was concerned with a bad leaver provision in a company's Articles of Association. The company had an interest in the faithful and diligent performance by the shareholders of their duties as employees and also in preserving its reputation. Although these interests were non-financial in nature, the company was entitled to protect them and the clause was not penal.

E. The Characteristics of the Contracting Parties

The characteristics of the parties are also potentially relevant. In *Makdessi*, Lord Neuberger and Lord Sumption said that “in a negotiated contract between properly advised parties of comparable bargaining power, the strong initial presumption must be that the parties themselves are the best judges of what is legitimate in a provision dealing with the consequences of breach”.¹²¹ These considerations were taken into account in *Makdessi*, with weight given to the fact that the contract had been the subject of detailed negotiations for many months between sophisticated commercial parties, dealing with each other on an equal basis with the benefit of specialist legal advice.¹²²

These considerations are different from those already considered. They do not relate to the terms or objectives of the contract or the consequences of breach. Rather, they are concerned with the attributes of the parties and the circumstances in which the contract was negotiated. They are principally relevant to one class of contracting parties, that is, sophisticated, commercial parties of a substantial size. In effect, parties belonging to this class are treated differently and it is more likely that damages clauses that go beyond compensation in their contracts will be enforceable.¹²³ As one commentator put it, “the ‘strong initial presumption’ approach suggests that affirmative evidence of procedural fairness may weigh heavily enough to turn a substantively dubious clause into one that passes the validity test”. In contrast, for parties not belonging to this class, there is a higher hurdle to satisfy.¹²⁴

The relevance of the characteristics of the parties to the validity of a damages clause is not new. In the 20 years before *Makdessi* was decided, the courts had taken an increasingly liberal approach to damages clauses in commercial contracts that were large but not oppressive. There had been growing judicial reluctance to intervene and more inclination to respect the wishes of the parties by upholding freely negotiated damages clauses, even if the

¹¹⁹ *Ibid.* at [47].

¹²⁰ [2016] CSIH 68 (Court of Session Scotland).

¹²¹ At [35] per Lord Neuberger and Lord Sumption; [152] per Lord Mance.

¹²² At [82] per Lord Neuberger and Lord Sumption; [181] per Lord Mance.

¹²³ See the post-*Makdessi* case, *BHL v Leumi ABL Ltd* [2017] EWHC 1871 (QB) in which this consideration was relevant.

¹²⁴ Summers “Unresolved Issues” at pp. 217-8.

stipulated sum was greater than the loss that was actually or might conceivably be suffered. Questions of whether the sum was a genuine pre-estimate of loss appeared to be displaced by consideration of a wider range of factors. These included the bargaining positions of the parties and whether they were advised,¹²⁵ the commercial justifiability of the clause,¹²⁶ and the reasonableness of the agreed sum.¹²⁷

The rationale for the “strong initial presumption” is that contract terms that are genuinely negotiated at arm's length by sophisticated parties advised by experts are inherently unlikely to be abusive or oppressive. These parties are regarded as being capable of protecting their interests. If they consider that compensation is inadequate and require a remedy that is more robust, they should be taken to understand the interests at stake and implications. The court will be slow to interfere.¹²⁸

The presumption does however have the potential to make the requirement of a legitimate interest in performance easily satisfied. Sophisticated parties will usually have good (business) reasons for requiring performance as opposed to mere compensation. If the court interferes, this risks being perceived as the imposition of its own views over those of the parties as to what interests are deserving of protection, but it is questionable whether the court is equipped to make such commercial judgements or at least better equipped than the parties.

There is also evidence to suggest that, since *Makdessi*, practitioners and sophisticated parties have sought to reinforce the presumption by providing expressly in their contracts that they have a legitimate interest in performance. New boiler plate clauses can be found in online legal knowhow service for practitioners which state: “The parties confirm that these liquidated damages are reasonable and proportionate to protect [Party 1]’s legitimate interest in performance”.¹²⁹ These clauses are an attempt to persuade the court still further that the remedy to which the parties have agreed is appropriate and reasonable, even if non-compensatory in nature. They are intended to increase the likelihood that the remedy will be enforced. Whilst it is doubtful that the courts will feel bound by such provisions, it can be expected that in some cases they will have at least some bearing on whether a legitimate interest in the remedy is found to exist.

V. CONCLUSION

The requirement of a legitimate interest in performance that goes beyond compensation in the new rule on penalties is somewhat elusive. It was not explained in any detail in *Makdessi* and its scope remains open to conjecture. Guidance can be found in concepts of legitimate interest that have featured in other contexts such as *White and Carter*, specific performance and gain-based damages. However the parallels inevitably only go so far, not least because there is also uncertainty in relation to the requirement in some of these contexts.

¹²⁵ *Philips Hong Kong Ltd v The AG of Hong Kong* (1993) 61 B.L.R. 41 (PC) 5-9 per Lord Woolf; *Tullett Prebon Group Ltd v El-Hajjali* [2008] EWHC 1924 (QB) [32]-[34] per Nelson J.; *Azimut-Benetti SpA v Healey* [2011] 1 Lloyd’s Rep. 473 (QB).

¹²⁶ *Lordsvale Finance plc v Bank of Zambia* [1996] Q.B. 752, 763-4 per Colman J.; *Murray v Leisureplay plc* [2005] EWCA Civ. 963 (CA).

¹²⁷ *Murray v Leisureplay plc* [2005] EWCA Civ. 963 (CA), [106] per Clarke J.; *Alfred McAlpine Capital projects Ltd v Tilebox Ltd* [2005] B.L.R. 271 (QB) 48 per Jackson J.; *Tullett Prebon Group Ltd v El-Hajjali* [2008] EWHC 1924 (QB) [38] per Nelson J..

¹²⁸ *Makdessi* at [33] (Lord Neuberger and Lord Sumption).

¹²⁹ PLC, Practical Law Commercial, Standard Clause 5-378-7443 (2017).

As often is the case after a judgment that recasts an established rule, more cases are needed to define the scope of the requirement. Thus far, the cases that have followed *Makdessi* have focused mainly on other aspects of the new test, in particular the distinction between primary and secondary obligations¹³⁰ and the requirement that the detriment imposed by the clause be unconscionable in comparison with the legitimate interest being protected.¹³¹ It is to be hoped that the requirement will soon benefit from similar judicial focus and can be articulated so as to be clearly understood by contracting parties and applied in a predictable manner.

¹³⁰ *Richard v IP Solutions Group Ltd* [2016] EWHC 1835 (Ch.); *Hayfin Opal Luxco 3 S.A.R.L., Hayfin Topaz 3 S.C.A. v Windermere VII CMBS plc, U.S. Bank Trustees Ltd, Elavon Financial Services Ltd* [2016] EWHC 782 (Ch.); *BHL v Leumi ABL Ltd* [2017] EWHC 1871 (QB)

¹³¹ *First Personnel Services Ltd v Halfords Ltd* [2016] EWHC 3220 (Ch.); *Hayfin Opal Luxco 3 S.A.R.L., Hayfin Topaz 3 S.C.A. v Windermere VII CMBS plc, U.S. Bank Trustees Ltd, Elavon Financial Services Ltd* [2016] EWHC 782 (Ch.).