IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

I TE KŌTI MATUA O AOTEAROA
TĀMAKI MAKAURAU ROHE

CIV 2016-404-2940
[2018] NZHC 32

BETWEEN	HONEY BEES PRESCHOOL LIMITED First Plaintiff
	JASON JAMES Second Plaintiff
AND	127 HOBSON STREET LIMITED First Defendant
	SUNIL GOVIND PARBHU ALSO KNOWN AS DENNIS PARBHU Second Defendant

Hearing: 18 September 2017

Appearances: S Khan, M Orange and C M Fisher for Plaintiffs
R M Dillon for Defendants

Judgment: 31 January 2018

[REDACTED] JUDGMENT OF WHATA J

This judgment was delivered by Justice Whata on 31 January 2018 at 4 pm
pursuant to r 11.5 of the High Court Rules

Registrar/Deputy Registrar

Date: ....

Solicitors: Fortune Manning, Auckland
Queen City Law, Auckland

Introduction

[1] Honey Bees Preschool Limited (Honey Bees) runs a childcare facility. It leases premises from 127 Hobson Street Limited (127 Hobson). A Collateral Deed to the Deed of Lease required:

(a) 127 Hobson to install a second lift in the leased premises; and

(b) if the second lift was not fully operational on or before 31 July 2016, 127 Hobson and its director, Dennis Parbhu, to indemnify Honey Bees and its director, Mr James, for all obligations they may incur to 127 Hobson to the expiry of the lease.

[2] The lift was not installed by the due date. Honey Bees and Mr James now seek to enforce the indemnity. Two defences are raised to the plaintiffs' claim, namely:

(a) the obligation to indemnify is an unenforceable penalty; and

(b) the Collateral Deed was obtained in circumstances such that it amounts to an unconscionable bargain.[1]

The issues

[3] The apparent simplicity of the foregoing narrative belies a claim of some complexity. Contractual penalties are unenforceable. A routine example of a contractual penalty is a remedial clause stipulating the payment of an extravagant or exorbitant sum of money for a relatively trivial breach of contract.[2] But the rule against penalties was recently recast in the United Kingdom[3] and Australia.[4] The assessment in those jurisdictions has shifted focus from whether the remedial clause stipulates a genuine pre-estimate of damages to whether the clause protects a

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1 This ground was not clearly pleaded, but I nevertheless address it below at [100].

2 See for example *Commissioner of Public Works v Hills* [1906] AC 368 (PC); *O'Dea v Allstates Leasing System (WA) Pty Ltd* (1983) 152 CLR 359 (HCA); and *General Finance Acceptance Ltd v Melrose* [1988] 1 NZLR 465 (HC).

3 *Cavendish Square Holding BC v Makdessi* [2015] UKSC 67, [2016] AC 1172 [*Cavendish*].

4 *Andrews v Australia New Zealand Banking Group Ltd* [2012] HCA 30, (2012) 247 CLR 205 [*Andrews*]; *Paciocco v Australia New Zealand Banking Group Ltd* [2016] HCA 28, (2016) 258 CLR 525 [*Paciocco*].

legitimate performance interest. If so, in either case, the clause will not be a penalty. This recasting (or redirection[5]) has been described as a "significant shift in perspective for the review of alleged penalties."[6] A central issue in this case is whether the law of penalties should be recast in similar fashion in this jurisdiction.

[4] A second issue, raised with some venom by the defendants, concerns the scope of the penalty rule in New Zealand, and whether breach of a contractual obligation is required to engage the penalty rule. In the present case, the defendants claim, adopting recent high authority in Australia, there is no requirement for breach.[7] The plaintiffs respond, relying on more recent high authority from the United Kingdom, there must be an antecedent breach of a contractual obligation to attract the penalty rule.[8]

[5] As the present proceedings involve two defendants, the claims therefore give rise to the following questions:

(a) What is the threshold test for a penalty?

(b) What is the scope of the penalty rule in New Zealand?

(c) Does 127 Hobson's obligation to indemnify engage the penalty rule?

(d) Does Mr Parbhu's obligation to indemnify engage the penalty rule?

(e) If the answer to (c) and/or (d) is yes, is the obligation to indemnify a penalty?

(f) If the obligation to indemnify is a penalty, what is the appropriate remedy, if any?

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5 As it was recently put in *Wilaci Pty Ltd v Torchlight Fund No 1 LP (in rec)* [2017] NZCA 152, [2017] 3 NZLR 293 [*Torchlight*].

6 J W Carter, Wayne Courtney and G J Tolhurst "Assessment of Contractual Penalties: *Dunlop* Deflated" (2017) 34(1) JCL 4 at 4.

7 *Andrews*, above n 4.

8 *Cavendish*, above n 3.

[6] A separate inquiry into whether the Collateral Deed is an unconscionable bargain is also then required.

Background

[7] Mr James owns and operates Honey Bees. In 2011 and 2012 he and his wife started looking into investing in or establishing a pre-school facility. They found out about premises owned by 127 Hobson from an advertisement placed by Anthony Gilbert, a business broker acting for Mr Parbhu. The advertisement stated the landlord "has been through all of the challenges of getting approval from the Fire Department, MOE and Council etc". It also stated the premises "have been constructed with an allowance for 40 plus children, maybe as many as 50." It continued "[t]he landlord is looking for an experienced operator to take on a long term commercial lease at a rent of $56 per child based on whatever MOE dictate the space may be licenced for." Finally, it refers to the possibility of "an opportunity for some discounted rent while the centre is building occupancy".

[8] Mr James registered his interest in the property. He was selected by Mr Parbhu as the preferred lessee. Mr Parbhu is a director of 127 Hobson and owns and/or manages a commercial property portfolio worth an estimated [redacted]. He vetted all prospective lessees of the premises and chose Mr James because he considered he "would be a good operator" and "would make a success of the business". An agreement to lease the premises at 127 Hobson Street was executed by Mr James and 127 Hobson on 28 August 2012. Key terms included a six-year lease period with three rights of renewal, a rental based on a rate of $56 per child per week, a minimum rental based on 48 children and a lease premium of $90,000. The commencement date was 60 days after due diligence. A plan of the leased premises sent to Mr James during the due diligence period shows two lifts.

[9] Due diligence was not smooth sailing. Mr James discovered fire approval was given for over three year olds only, which impacted Honey Bees' prospective market. Due diligence was extended to 10 September 2012 and a variation to the agreement to lease was executed the following day. Among other things, adjustments were made to the commencement date, the rent holiday was extended to 31 December 2012 and the

initial base rent was fixed for the first three years. There was no mention of a requirement for a second lift in the agreement, the variation to the agreement or associated correspondence.

[10] During the months that followed Honey Bees was permitted access to the premises. Mr James identified several problems with the property. Threat and counterthreat were made to cancel the agreement. They came to nothing. Rather, steps were taken, at some considerable cost, by both Honey Bees and 127 Hobson to make the premises suitable for a pre-school facility. Initially Ministry of Education approval proved elusive, but on 16 December 2013 it approved a licence for 24 children on a probationary basis.

[11] Negotiations then ensued to finalise the terms of lease, particularly between Mr James and Mr Gilbert. The following key negotiated points were recorded by Mr Gilbert in an email to Mr James dated 18 December 2013:

(a) The Lease was to commence in January 2014 "at $145,600 plus GST and all outgoings".

(b) There would be a rent discount of 50 per cent for 14 months.

(c) The lease premium, of $90,000 plus GST, was payable on commencement.

(d) Rent was to be fixed for the first three years.

(e) The second lift would be addressed as follows:

> [Mr Parbhu] to commit to put in second lift before 2017, or earlier if needed, this is not to be part of lease. [Mr Parbhu] to provide a personal guarantee or something else to make you happy.

(f) Mr James would have the right to terminate or renegotiate the lease if regulations changed and his licence "cannot go to 50 for any reason".

[12] The previous day Mr Gilbert emailed Mr Parbhu discussing these points, to which Mr Parbhu responded. Among other things, the second lift was discussed (with Mr Parbhu's comment italicised):

> The necessity of a second lift is almost certainly going to become an issue as the license increases from 24 to 50. There will need to be some commitment by the landlord in the lease that a second lift is commissioned at some time in the future. *This is not in my control financially the fact that I have not received full rent to date and for the next months ahead make this very difficult so I cannot commit to this; I can say that it is on my wish list given that I live here.*

[13] Mr Parbhu added that:

> Jason needs to quickly send an email accepting the terms and conditions of our lease agreement that you have provided, otherwise we will have no agreement and I will have no space to move but to take it that no lease exists.

[14] This correspondence was followed by a detailed letter from Mr James to Mr Gilbert on 19 December 2013 confirming his position on, among other things, an "exit clause", car parking and the second lift. Relevantly, he noted:

> 7. Second Lift – To be installed and operating by 6th January 2016 and the trust who owns the building will need to enter into a separate deed agreeing to put the lift in and will need to be signed at the same time as the lease deed.

[15] Mr Parbhu responded to Mr James' comments the same day in an email to Mr Gilbert, rejecting many of the proposed requirements as of nuisance value only. He stated the second lift was: "[n]ot agreed, we have always maintained that when possible a lift will be put in; [o]ne clearly cannot commit to something if confidence is not there that this can be financially accommodated."

[16] It is not clear Mr James was given a copy of Mr Parbhu's response. In any event, a draft variation agreement prepared by Mr Gilbert was sent to both Mr James and Mr Parbhu on the morning of 20 December 2013. In the same correspondence, Mr Gilbert records:

> The lift issue will be as a side agreement [to be done today] where Dennis personally, and as a director of 127 Hobson Street Ltd, agrees to install a second lift before August 2016. Such agreement shall be drafted by solicitors. This document will not go to Dennis's bank, where this one page confirmation will.

[17] In his email response, Mr Parbhu indicated he agreed with the proposed draft, but noted the rent holiday and backdating of outgoings remained an issue. Mr Gilbert then circulated a "Final proposed" agreement the same day. Mr James responded seeking an amendment in relation to the right to terminate.

[18] A further draft of a proposed variation agreement was then sent by Mr Gilbert to Mr Parbhu and Mr James at 2.01 pm. His email recorded Mr James' lawyer wanted to convert the agreement to a formal lease, and that they could add that $10,000 will be payable for backdated outgoings. It also recorded Mr James' lawyer mentioned "the guarantee document to be signed by [Mr Parbhu], also needs to be signed at the same time as the deed of lease".

[19] The draft variation of agreement to lease included the following clauses:

> 1. The lease shall commence in the first two weeks of January 2014. The vendor's solicitor shall prepare the lease with no changes to the standard lease other than what is included in this document and the legal agreement to lease dated 28 August 2012. Outgoings & Rent shall commence from 6th January.
>
> 2. The Ministry of Education Licence of 24 children as of today (20 December 2013), as confirmed by the Ministry of Education. The Ministry of Education have confirmed that the building measures up for a maximum of 50 children.
>
> 3. The commencement rental shall be 50% of the contractual rental - $56 x 50 children x 52 weeks, thereafter the rent will revert to $145,600 plus GST.
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> 4. Rent holiday of this 50% rental as per point 3 above will be 14 months from January 2014, thereafter the rent will revert to $145,600 plus GST.
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> 5. The basis of rent review will be annual CPI, but the rent will be fixed for a period at $145,600 p.a. (excluding the 14 month rent holiday) for 6 years.
>
> 6. Guarantees – if the lease ends for whatever reason all guarantors are released from all liability.
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> 7. If at any time after the commencement of the lease, there is any change in circumstances beyond the control of the lessee which has the effect of restricting or impeding the ability of the lessee to obtain 50 licences from the Ministry of Education, the lessee shall have the right to immediately terminate the lease, or re-negotiate the terms of the lease while preserving the lessee's right to terminate the lease. For the avoidance of doubt, circumstances beyond the lessee's control will

include, without limitation, changes relating to Council, Ministry of Education and Fire Service requirements.

8. Fixtures & Fittings – if the lease ends for whatever reason we have the right to remove all of the fixtures & fittings we have installed and no reinstatement of the building changes we have made will be required.

9. The lease premium of $90,000.00 plus GST is payable by the lessee on the execution of the lease.

[20] Mr Parbhu expressed concerns about clauses 6 and 7. In any event, a deed of lease and collateral deed were then drafted by Mr James' solicitors, with copies sent to Mr Parbhu at 3.42 and 3.50 pm respectively. A second version of the lease was then sent to Mr Parbhu at 4.08 pm.

Deed of Lease and Collateral Deed

[21] About this time, Mr James attended Mr Parbhu's offices and they executed the Collateral Deed. It states:

Background

A. Honey Bees is the lessee and Jason is the guarantor under a Deed of lease dated on or about the date of this deed ("the Lease") entered into with 127 Hobson in respect of the premises on the fifth floor of 127 Hobson Street, Auckland (Premises) in replacement of an agreement to lease between Jason and 127 Hobson.

B. 127 Hobson and the Guarantor covenant as set out in this deed for the benefit of Honey Bees and Jason.

…

1. 127 Hobson agrees to install at its sole cost and expense a second lift in the building in which the Premises are located providing direct access to the Premises.

2. 127 Hobson and the Guarantor agree that in the event that the second lift was not fully operational on or before 31 July 2016 then 127 Hobson and the Guarantor jointly and severally hereby indemnify Honey Bees and Jason jointly and severally for all obligations they may incur to 127 Hobson or any other landlord under the Lease including the payment of rent, operating expenses and other payments as provided under the Lease to the expiry of the Lease.

3. This deed is collateral to the Lease.

[22] The Deed of Lease, dated 20 December 2013, was subsequently executed by Honey Bees and 127 Hobson, with Mr James as Guarantor. The first schedule to the Lease records the key terms. It is attached as an appendix to this judgment.

Post-execution events

[23] The relationship between 127 Hobson and Honey Bees remained fraught after the Lease formally commenced. A dispute arose as to whether the deposit paid by Honey Bees discharged the initial rental payments due on 20 January, 20 February and 20 March 2014. 127 Hobson claimed the deposit had been spent prior to the commencement of the Lease. Honey Bees disagreed. The matter was resolved by Brown J in Honey Bees' favour.[9]

[24] Litigation issues aside, the pre-school has been successful. It has been fully licensed since August 2015, and is operating at full capacity. By contrast, the installation of the lift has not gone to plan. Obtaining building consent for the installation proved difficult. A structural beam had to be removed, causing delay during both the consenting and construction phases. Installation was also cumbersome; with complaints from tenants (including Honey Bees) and corresponding constraints on construction hours, it has taken longer than anticipated. In the result, the installation was almost 14 months overdue at the time of the hearing.

The evidence

[25] Much energy was expended in the evidence on the issue of whether Mr James had a legitimate interest in securing the second lift and in seeking an indemnity from the defendants. The circumstances leading up the execution of the Lease and Collateral Deed, the use of the current lift, the need for a second lift and the reasons for the delay in installing the lift were also matters of importance and contention for the parties. It is not necessary to traverse that evidence in detail. The salient background is set out above. I will record my main findings when I come to resolve the key questions.

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9 *Honey Bees Preschools Ltd v 127 Hobson Street Ltd* [2014] NZHC 2942.

(a) What is the threshold test for a penalty?

United Kingdom and Australia

[26] The history and modern application of the penalty rule or doctrine is thoroughly traversed by the United Kingdom Supreme Court in *Cavendish* and by the High Court of Australia in *Andrews* and *Paciocco*. The Court of Appeal in *Torchlight* also recently reviewed the approach taken by those Courts.[10] The Court there was dealing with a contract subject to New South Wales law so, like *Cavendish* and *Paciocco,* it is not binding authority. Nevertheless, I cannot improve on the description of the origins of the penalty rule précised by the Court of Appeal:

> [69] Equity, where the doctrine first emerged, restrained actions to enforce defeasible bonds where the true intent inferred was that the bond served as security only for payment of the primary obligation. Such a bond would involve the borrower executing an instrument for a sum typically twice the sum lent, binding the borrower to pay the lender the larger sum on a fixed day, with the proviso that if payment of the lesser sum lent was first made, the bond would become void. By the second half of the 17th century equity would invariably view the greater sum as penal and award relief upon payment of the lesser sum plus costs and interest. The true nature of the obligation to pay the penalty was securing and secondary. The equitable doctrine was inapplicable where damages were not readily assessable, and developed alongside equitable relief against forfeiture in mortgages and leases. Equitable relief for penalties logically should be viewed now through the modern lens of unconscionability.
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> [70] Common law began to offer relief on the same terms, and statutes passed in 1697 and 1705 regularised the position. Common law's initiative drew on its equitable competitor. But its constraint on penalties was based on public policy objections that punitive provisions in contract should not be given effect at all. The remedial function of the common law of contract was confined to the achievement of performance expectations. Enforcing punishments formed no part of that.
>
> (footnotes omitted)

[27] By the early twentieth century, the scope and application of the penalty rule was largely shaped by Lord Dunedin's speech in *Dunlop*.[11] His Lordship identified the following dichotomy:[12]

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[10] *Torchlight*, above n 5.

[11] *Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd* [1915] AC 79 (HL). See also discussion in *Cavendish*, above n 3, at [22].

[12] At 86.

> 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 …

[28] Lord Dunedin also explained that whether a sum is a penalty is a question of construction to be decided upon the terms and inherent circumstances of each contract, judged at the time of the making of the contract, not at the time of the breach.[13] To assist the interpretative task, Lord Dunedin identified four "helpful" tests, namely:[14]

(a) It will be a 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 breach.

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

(c) There is a presumption 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 damages.

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

[29] However, as alluded to, the United Kingdom Supreme Court recast the threshold test in *Cavendish*. Lords Neuberger and Sumption, with whom Carnwath concurred, stated the threshold test for a penalty clause is now:[15]

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13 At 86-87.
14 At 87-88.
15 *Cavendish*, above n 3, at [32].

> [W]hether the impugned provision is a secondary obligation which imposes a detriment on the contract-breaker out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation.

[30] Lord Hodge, with whom Lords Clarke and Toulson agreed, put the test slightly differently (but to similar effect):[16]

> … the correct test for a penalty is whether the sum or remedy stipulated as a consequence of a breach of contract is exorbitant or unconscionable when regard is had to the innocent party's interest in the performance of the contract.

[31] These tests are "motivated by a concern to promote freedom of contract"[17] and premised on the core idea that the purpose of contract is to satisfy the expectations of the party entitled to performance.[18]

[32] The approach taken in the judgments in *Paciocco* dovetails with those in *Cavendish*. Kiefel J, with whom French CJ agreed, adopted as a threshold test whether the substituted obligation is "out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation".[19] Keane J preferred to adopt Lord Hodge's framing of the question.[20] Gageler J focused on whether the exclusive purpose of the clause was to punish in order to deter breach, concluding "the relevant indicator of punishment lies in the negative incentive to perform being so far out of proportion with the positive interest in performance that the negative incentive amounts to deterrence by threat of punishment."[21]

[33] The full implications of this recasting are explained by the Court in *Torchlight* in the following terms. First, Lord Dunedin's dichotomy between penalty and legitimate liquidated damages is a false one, or at least not exclusive. The real question when a contractual provision is challenged as a penalty is whether it is penal, not whether it is a pre-estimate of loss.[22] Second, the tests laid down in *Cavendish* reinstate a pre-*Dunlop* focus on whether the substituted obligation is unconscionable

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16 At [255]. To similar effect, see also Lord Mance's judgment at [143] and [152].
17 Carter, above n 3, at 5.
18 *Cavendish*, above n 3, at [30], citing *Co-operative Insurance Society Ltd v Argyll Stores (Holdings) Ltd* [1998] AC 1 at 15 per Lord Hoffmann. See also the judgment of Lord Hodge at [243].
19 *Paciocco*, above n 4, at [54] and [57].
20 At [270].
21 At [164]-[165].
22 *Torchlight*, above n 5, at [80].

or extravagant.[23] Third, relevant considerations include whether both parties are commercially astute, have relatively similar bargaining power, and are advised; and if so, the strong presumption must be that the parties themselves are the best judges of what is legitimate in a provision dealing with the consequences of breach.[24] Fourth, the mere fact a clause substituting one scale of performance is designed to deter breach does not mean it is penal (but, as Lords Neuberger and Sumption emphasised, a clause designed to punish is penal).[25]

[34] The Court also derived a similar set of principles from the various judgments in *Paciocco*, which it considered consistent with those in *Cavendish*: (a) the justification for the rule lies in an amalgam of equity and the common law rule based on public policy; (b) a provision whose sole or dominant purpose is to punish the contract-breaker is contrary to public policy; (c) the test is not simply a comparison between contractually stipulated and court-imposed damages; rather (d) the fundamental question is whether the impugned obligation is out of all proportion to any legitimate interest in enforcement of the primary obligation, or exorbitant, or unconscionable, having regard to performance interests.[26]

[35] With these principles in mind, the Court of Appeal identified "four points of context" in resolving whether, in that case, a late payment fee was a penalty:[27]

(a) the commercial context of the transaction;

(b) each party stood to make substantial gains;

(c) the transaction involved high risk to the innocent party; and

(d) the late payment fee was less than the equivalent cost of credit in the primary transaction.

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23 At [81].
24 At [82].
25 At [83].
26 At [85]-[88].
27 At [90]-[94].

[36] In the result, the Court concluded the late payment fee was not a penalty. In doing so it emphasised the relevant inquiry is not what damages the lender might have received or whether it is designed to deter, unless the deterrence is designed to punish.[28]

New Zealand

[37] The most authoritative statement on the law of penalties in New Zealand is the Court of Appeal decision in *Amaltal Corporation Ltd*.[29] That case examined whether the penalty rule was a matter of public policy for the purpose of setting aside an arbitral award under the Arbitration Act 1996. The Court concluded it was not. It added:[30]

> … the rule is simply a branch of equity's relief jurisdiction, supplemented by developments in the common law … whereby oppression of a party to a contract may be prevented. When Lord Radcliffe said in *Campbell Discount v Bridge* at p 622 that the refusal to sanction legal proceedings for penalties "is in fact a rule of the court's own, produced and maintained for purposes of public policy", he was saying nothing more than that the rule was developed by the Courts with a view to limiting the use of a certain kind of contractual stipulation which had the potential for oppression.

[38] It also cited with approval the joint judgment of Mason and Wilson JJ in *AMEV-UDC Finance Ltd*, including the following passage:[31]

> … equity and the common law have long maintained a supervisory jurisdiction, not to rewrite contracts imprudently made, but to relieve against provisions which are so unconscionable or oppressive that their nature is penal rather than compensatory. The test to be applied in drawing that distinction is one of degree and will depend on a number of circumstances, including (1) the degree of disproportion between the stipulated sum and the loss likely to be suffered by the plaintiff, a factor relevant to the oppressiveness of the term to the defendant, and (2) the nature of the relationship between the contracting parties, a factor relevant to the unconscionability of the plaintiff's conduct in seeking to enforce the term. The courts should not, however, be too ready to find the requisite degree of disproportion lest they impinge on the parties' freedom to settle for themselves the rights and liabilities following a breach of contract. The doctrine of penalties answers, in situations of the present kind, an important aspect of the criticism often levelled against unqualified freedom of contract, namely the possible inequality of bargaining power. In this way the courts strike a balance between the competing interests of freedom of contract and protection of weak contracting parties …

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28 At [95]-[97].

29 *Amaltal Corporation Ltd v Maruha (NZ) Corporation Ltd* [2004] 2 NZLR 614 (CA). For an application of the penalty rule in New Zealand, see *General Finance Acceptance Ltd v Melrose*, above n 2.

30 At [56].

31 At [57], citing *AMEV-UDC Finance Ltd v Austin* (1986) 162 CLR 170 (HCA) at 193-194.

[39] The Court then concluded:

> [59] So the rule, which certainly is one developed in the public interest, is concerned with relief against oppression or unconscionable behaviour by a contracting party. Unlike the principles governing the supervening effect of illegality, it has always been recognised as being subject to fairly narrow constraints …

[40] This explanation of the normative basis of the penalty rule broadly aligns with the explanation provided in *Torchlight,* namely a concern that remedial clauses not be oppressive or unconscionable. There are however two apparent points of substantive difference between the statements of law in *Amaltal* and in *Torchlight*. First, *Amaltal* describes the penalty rule as a branch of equity supplemented by developments in the common law. [32] By contrast, in *Cavendish* Lords Neuberger and Sumption suggest there has been no trace of equitable jurisdiction since the fusion of law and equity in 1873.[33] This largely accords with the view expressed by Mason and Wilson JJ in *AMEV-UDC Finance Ltd* who observed the equitable jurisdiction to relieve against penalties "withered at the vine."[34]

[41] Second, as evident in the passage at [38] above, in *Amaltal* the difference between the stipulated sum and the likely loss to be suffered by the plaintiff was determinative of whether the clause was a penalty. This appears to remain the settled position in New Zealand,[35] but has been substantially qualified in the United Kingdom and Australia. As explained above, the focus in those jurisdictions is now whether the clause protects and is not out of all proportion with a legitimate performance interest.

[42] It may be that in New Zealand equity remains the source of the penalty rule. Certainly, the rule employs language more familiar to equity than the common law. And, as Mr Dillon submits, if there is any conflict or variance between the rules of equity and the rules of the common law in relation to the same matter, the rules of

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32 *Amaltal*, above n 29, at [56]
33 *Cavendish*, above n 3, at [42]
34 *AMEV-UDC Finance Ltd*, above n 31, at 191,
35 See Andrew Butler *Equity and Trusts in New Zealand* (2nd ed, Thomson Reuters, Wellington, 2009) at [21.3.1]. See also *General Finance Acceptance Ltd v Melrose*, above n 2, at 470-471, adopting the approach of the High Court of Australia in *O'Dea v Allstates Leasing System (WA) Pty Ltd*, above n 2.

equity prevail.[36] But it appears generally accepted the penalty rule is a rule of the common law rather than equity.[37]

[43] As to the second point of difference, I would not jettison altogether the pre-estimate of loss/stipulated sum comparison in appropriate cases, not least because it was endorsed by the Court of Appeal in *Amaltal*.[38] Compensatory damages for loss remain the primary remedy for breach of contract.[39] A stipulated sum that is out of all proportion to likely compensatory damages for breach is prima facie extravagant and exorbitant.[40] Furthermore, the pre-estimate of loss/stipulated sum comparison may be usefully applied in a great many cases if a broad conception of likely loss is adopted, including, for example, indirect losses[41] or cost of cure,[42] or where the performance interest is a contract sum (a point made by Lords Neuberger and Sumption in *Cavendish*).[43] Finally the fourth *Dunlop* category – see [28] above – contemplates circumstances where the comparison is inapposite, namely where likely loss is not quantifiable at the time of execution. It was never therefore a threshold test of universal application. In appropriate cases, it can sit comfortably alongside the redirection taken by the Courts in the United Kingdom and Australia.[44]

[44] However, in a context where the defaulting party is seeking to depart from the clear words of the contract, in agreement with the way the rule was recast in *Cavendish* and *Paciocco*, the innocent party's performance interests, having regard to the full context of the transaction, must be relevant when assessing whether a remedial clause

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36 Senior Courts Act 2016, s 180.

37 See Butler, above n 35, at [21.3.1].

38 Further, I think there is some merit to academic criticism about the redirection. Carter et al, above n 6, at 21 criticise the approach taken in *Paciocco* insofar as it departs from the *Dunlop* orthodoxy and promotes a "performance interest" based outcome rather than an assessment based on the damage likely to be caused by the breach. Jessica Palmer "Implications of the New Rule Against Penalties" (2016) 47 VUWLR 305 is also cautious about an approach that places emphasis on performance interests rather than the compensation principle.

39 Peter Blanchard *Civil Remedies in New Zealand* (2nd ed, Thomson Reuters, Wellington, 2011) at [1.1]; Brian Coote *Contract as Assumption: Essays on a Theme* (Hart Publishing, Oxford, 2010) at 134.

40 This was the accepted orthodoxy in cases before *Cavendish* and *Paciocco*, such as *Commissioner of Public Works v Hills*, above n 2, *O'Dea v Allstates Leasing System (WA) Pty Ltd*, above n 2, and *General Finance Acceptance Ltd v Melrose*, above n 2.

41 See also Carter et al, above n 6, at 20-21.

42 Coote, above n 39, at 130.

43 *Cavendish*, above n 3, at [32], and at [255] per Lord Hodge.

44 On my reading of *Cavendish*, that is in fact the point made in the various judgments. A similar observation is made in *Torchlight*, above n 5, at [80].

is a penalty. Relevantly, not all remedial clauses are compensatory in the true sense; they may respond to the breach by identifying an alternative or substituted performance obligation, as explained in *Torchlight*.

[45] Accordingly, I consider the principles set out in *Torchlight* provide a coherent frame for assessing whether a clause is an unenforceable penalty. The central issue is whether a stipulated remedy for breach is out of all proportion to the legitimate performance interests of the innocent party, or otherwise exorbitant or unconscionable, having regard to those interests. The following factors will be relevant to this assessment:

(a) whether the parties were commercially astute, had similar bargaining power and were independently advised; and

(b) whether the predominant purpose of the impugned clause is to punish (as opposed to simply deter) non-performance.

[46] In addition, in appropriate cases, a comparison between likely loss and the stipulated sum may be relevant, particularly where the performance interest is a contract sum.

(b) Preliminary issue: what is the scope of the penalty rule?

[47] Much argument before me concerned the scope of the penalty rule. The penalty rule in Australia does not require a breach of a contractual obligation. Rather, the High Court of Australia stated in *Andrews*:[45]

> In general terms, a stipulation prima facie imposes a penalty on a party (the first party) if, as a matter of substance, it is collateral (or accessory) to a primary stipulation in favour of a second party and this collateral stipulation, upon the failure of the primary stipulation, imposes upon the first party an additional detriment, the penalty, to the benefit of the second party. In that sense, the collateral or accessory stipulation is described as being in the nature of a security for and in terrorem of the satisfaction of the primary stipulation.

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45 At [10] (footnotes omitted).

[48] Lords Neuberger and Sumption were not at all comfortable with the notion a conditional primary obligation can amount to a penalty, because it is not premised on breach of a contractual obligation. They stated in *Cavendish*:[46]

> The equitable jurisdiction to relieve from penalties arose wholly in the context of bonds defeasible in the event of the performance of a contractual obligation. It necessarily posited a breach of that obligation. … Finally, the High Court's decision does not address the major legal and commercial implications of transforming a rule for controlling remedies for breach of contract into a jurisdiction to review the content of the substantive obligations which the parties have agreed. Modern contracts contain a very great variety of contingent obligations. Many of them are contingent on the way that the parties choose to perform the contract. There are provisions for termination on insolvency, contractual payments due on the exercise of an option to terminate, break-fees chargeable on the early repayment of a loan or the closing out of futures contracts in the financial or commodity markets, provisions for variable payments dependant on the standard or speed of performance and "take or pay" provisions in long term oil and gas purchase contracts, to take only some of the more familiar types of clause. The potential assimilation of all these to clauses imposing penal remedies for breach of contract would represent the expansion of the courts' supervisory jurisdiction into a new territory of uncertain boundaries, which has hitherto been treated as wholly governed by mutual agreement.

[49] This question is relevant for present purposes because the plaintiffs contend the defendants' obligation to indemnify is a primary obligation, and therefore not subject to the penalty rule. The defendants submit *Andrews* is good law insofar as it identifies that in equity, a breach of a primary obligation is not a prerequisite to the application of the penalty rule. This issue was not directly addressed by the Court of Appeal in *Torchlight*. Given my interpretation of cl 2 below, it is unnecessary for me to rule on this question with finality. I nevertheless turn to briefly address it given the time spent on it in argument.

[50] The concept of primary and secondary obligations is a cornerstone of contract law. As stated by Professor Coote:[47]

> A party to a contract is subject to primary obligations to perform his undertakings and to corresponding sanctioning or secondary obligations to pay compensation if he commits a breach. At common law the two are inseparable, in the sense that no primary obligation arises unless the party concerned has also accepted the sanctioning obligations that go with it.

46 Cavendish, above n 3, at [42].
47 Coote, above n 39, at 106.

[51] Lords Neuberger and Sumption also explained the rationale for this taxonomy and its operation in penalty cases in *Cavendish*:

> [13] This principle is worth restating at the outset of any analysis of the penalty rule, because it explains much about the way in which it has developed. There is a fundamental difference between a jurisdiction to review the fairness of a contractual obligation and a jurisdiction to regulate the remedy for its breach. Leaving aside challenges going to the reality of consent, such as those based on fraud, duress or undue influence, the courts do not review the fairness of men's bargains either at law or in equity. The penalty rule regulates only the remedies available for breach of a party's primary obligations, not the primary obligations themselves. This was not a new concept in 1983, when *ECGD* was decided. It had been the foundation of the equitable jurisdiction, which depended on the treatment of penal defeasible bonds as secondary obligations or, as Lord Thurlow LC put it in 1783 in *Sloman v Walter* 1 Bro CC 418, 419, as "collateral" or "accessional" to the primary obligation. And it provided the whole basis of the classic distinction made at law between a penalty and a genuine pre-estimate of loss, the former being essentially a way of punishing the contract-breaker rather than compensating the innocent party for his breach. We shall return to that distinction below.
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> [14] This means that in some cases the application of the penalty rule may depend on how the relevant obligation is framed in the instrument, ie whether as a conditional primary obligation or a secondary obligation providing a contractual alternative to damages at law. Thus, where a contract contains an obligation on one party to perform an act, and also provides that, if he does not perform it, he will pay the other party a specified sum of money, the obligation to pay the specified sum is a secondary obligation which is capable of being a penalty; but if the contract does not impose (expressly or impliedly) an obligation to perform the act, but simply provides that, if one party does not perform, he will pay the other party a specified sum, the obligation to pay the specified sum is a conditional primary obligation and cannot be a penalty.
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> [15] However, the capricious consequences of this state of affairs are mitigated by the fact that, as the equitable jurisdiction shows, the classification of terms for the purpose of the penalty rule depends on the substance of the term and not on its form or on the label which the parties have chosen to attach to it. As Lord Radcliffe said in *Campbell Discount Co Ltd v Bridge* [1962] AC 600, 622, "the intention of the parties themselves", by which he clearly meant the intention as expressed in the agreement, "is never inclusive and may be overruled or ignored if the court considers that even its clear expression does not represent 'the real nature of the transaction' or what 'in truth' it is taken to be" … This aspect of the equitable jurisdiction was inherited by the courts of common law, and has been firmly established since the earliest common law cases.

[52] The last sentence at [14] of *Cavendish* read in isolation may confuse. As I understand it, their Lordships identify an important difference between a "conditional primary obligation" and an obligation that is "collateral or accessional" to a primary obligation. In the former, performance of the primary obligation is simply triggered

by the occurrence of a specified event or condition. It is not, per *Cavendish*, subject to the penalty rule. In the latter, the obligation is responsive to and arises out of the non-performance or breach of a contractual obligation. It is therefore a secondary obligation and, per *Cavendish*, amenable to the penalty rule.

[53] The United Kingdom Supreme Court in *Cavendish* was in fact addressing two appeals; *Cavendish Square Holdings BV v Makdessi* and *ParkingEye Ltd v Beavis*. The facts in *ParkingEye* are illustrative of a secondary obligation. In that case Lords Neuberger and Sumption found penalty rule was plainly engaged.[48] The facts are mercifully simple. ParkingEye displayed signs recording that:

> … By parking within the car park, motorists agree to comply with the car park regulations. Should a motorist fail to comply with the car park regulations the motorist accepts that they are liable to pay a parking charge …

[54] The regulations allowed a maximum parking period of two hours; failure to comply would result in a parking charge of £85. The appellant, Mr Beavis, overstayed and was duly charged a fine of £85. Superficially, the obligation to pay the charge might be construed as a conditional primary obligation (that is an obligation arising on the occurrence of a specified event). But the clear objective of the impugned provision, in context, was not to agree terms for overstaying. Rather, its object was to protect against and sanction breach of a parking condition.[49]

[55] By contrast, the facts in the *Cavendish* appeal are illustrative of what amounts to a conditional primary obligation. *Cavendish* concerned an agreement for the sale and purchase of shares. Clause 5.1 of the agreement disentitled the sellers, if they defaulted on a restrictive covenant, from receiving payment which would otherwise have been due to them as their proportion of the price of transferred shares.[50] Lords Neuberger and Sumption were satisfied, having regard to the immediate commercial context, that the obligation to pay the full share price was a conditional primary obligation, and that the reduction in price was not a sanction for breach, but an

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48 *Cavendish*, above n 3, at [99].

49 At [94], [284], [298].

50 Clause 5.6 was also at issue. Under it each seller granted the purchaser the ability to require defaulting sellers to sell their shares to it within 30 days of receipt of a notice by the purchaser exercising its option in consideration for payment of a defined defaulting shareholder option price.

adjustment to the price to reflect the agreed value of the shares in the event the sellers failed to observe the restrictive covenant.[51]

[56] Gageler J's account in *Paciocco* of the significance of *Andrews* then helpfully bridges (somewhat) the apparent conceptual divide:[52]

> [125] The statement in *Andrews* that "[i]t is the availability of compensation which generates the 'equity' upon which the court intervenes" without which "the parties are left to their legal rights and obligations" is, in context, a reference to the historically important, although now comparatively rare, exercise of equitable jurisdiction to grant relief against penalties. The statements that, "[i]n general terms", a penalty is enforced "only to the extent" that compensation can be made for prejudice suffered by failure of the primary stipulation and that a party who can provide compensation "is relieved to that degree from liability to satisfy the collateral stipulation" are similarly directed to, and broadly descriptive of, the grant of equitable relief.
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> …
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> [127] For present purposes, the significance of *Andrews* lies in its explanation of the conception of a penalty as a punishment for non-observance of a contractual stipulation, in its explanation of that conception of a penalty as a continuation of the conception which originated in equity, and in its endorsement of the description of the speech of Lord Dunedin in *Dunlop* as the "product of centuries of equity jurisprudence".
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> (footnotes omitted)

[57] With this clarification in mind, I tend to prefer the view that the penalty rule or doctrine affixes only to secondary obligations (including collateral or accessory obligations) to compensate or make good on the breach of or failure to discharge primary obligations, for the reasons succinctly expressed by Lords Neuberger and Sumption.[53] I also gratefully adopt Professor Jessica Palmer's coherent explanation for the rule:[54]

> Contract law maintains a healthy respect for the parties' autonomy to make bargains, both good and bad. For this reason, the power afforded to the court by the penalty doctrine to ignore particular terms of the contract should not extend to rewriting parties' primary obligations. However, a viable contract law requires that courts must be able to enforce contracts. Enforcement is achieved indirectly by the recognition of a secondary obligation to require a

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51 At [74].

52 See also Kiefel J's comments at [18]-[23].

53 *Cavendish*, above n 3, at [4]-[18]; See also *Paciocco*, above n 4, at [18]-[23] per Kiefel J and [125]-[127] per Gageler J, and *Torchlight*, above n 5, at [68]-[89]. .

54 Palmer, above n 38, at 317. See also the reasoning in *Cavendish*, above n 3, at [12], *Paciocco*, above n 4, at [21].

> remedy (compensation) in the event of breach. Parties can attempt to incorporate a secondary obligation into the contract at the time of entering their primary obligations for the sake of efficiency and certainty, but courts must retain the ability to review and set aside secondary obligations that overreach the compensation principle and thus usurp the courts' authority.

Approach to interpretation

[58] Whether a clause is penal is essentially a question of construction. In this regard, I approach the interpretation of the Collateral Deed applying the usual rules,[55] overlaid by the guidance set out in *Cavendish* and *Paciocco*: it is necessary to look to the substance not form to assess whether cl 2 (a) engages the penalty rule and, if so, (b) is a penalty.

[59] It is necessary to preface the following discussion with a point of clarification. On my review of the authorities, I have found the interpretative exercise is usually a seamless examination of the meaning and effect, in context, of the impugned clause. Bright-line dichotomies between types of obligations have not driven the analysis in most cases. It is also evident in complex cases the true object of the clause does not necessarily become clear until the second step in the interpretative exercise is complete, namely the assessment of whether the clause is in fact a penalty.[56] This is important because a clause that appears amenable to the application of the penalty rule (applying orthodox rules of interpretation) may take on a different character with the benefit of the full proportionality assessment. The converse is equally true. In my view, therefore, the question of whether the penalty rule is engaged should be viewed simply as a gateway test, used to exclude obligations that are clearly primary rather than secondary obligations.

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55 A*ir New Zealand Ltd v New Zealand Air Line Pilots' Association Inc* [2016] NZCA 131, [2016] 2 NZLR 829 at [35]: "When interpreting a written contract, the court is concerned to identify the intention of the parties by reference to 'what a reasonable person having all the background knowledge which would have been available to the parties would have understood them to be using the language in the contract to mean' … And it does so by focussing on the meaning of the relevant words … in their documentary, factual and commercial context. That meaning has to be assessed in the light of (i) the natural and ordinary meaning of the clause, (ii) any other relevant provisions of the lease, (iii) the overall purpose of the clause and the lease, (iv) the facts and circumstances known or assumed by the parties at the time that the document was executed, and (v) commercial common sense, but (vi) disregarding subjective evidence of any party's intentions."

56 My comment here echoes that of Palmer, above n 38, at 319.

(c) Does 127 Hobson's obligation to indemnify engage the penalty rule?

[60] The terms of the Collateral Deed are stated at [21]. Clause 2 imposes an obligation on 127 Hobson to indemnify the plaintiffs for all their lease obligations if a second lift is not fully operational by 31 July 2016. Literally construed, this clause imposes a conditional primary obligation on 127 Hobson, as the plaintiffs contend. But, in context, as Mr Dillon submits for the defendants, 127 Hobson's obligation to indemnify at cl 2 seeks to secure the performance of 127 Hobson's primary obligation to install a second lift; while the obligation to indemnify is the sanction (as well as a substitute) for non-performance.

[61] My reasons for this conclusion are as follows. First, the evident object of the Collateral Deed is to secure the installation of a second lift in the leased premises by a specific date, rather than an indemnity per se. That construction is consistent with the negotiations leading up to the execution of the Collateral Deed, which make no mention of an obligation to "indemnify" at all.[57] The focal point of negotiations was always about securing the installation of the second lift within a specified timeframe. Second, the Collateral Deed is, explicitly, collateral to the Lease, the purpose of which is to secure a long-term leasehold that is fit for purpose, namely a fully licenced childcare facility. A primary obligation to install the second lift conforms to this purpose, as does a secondary obligation deterring non-performance. Third, the broader factual matrix, known to both parties, reveals (a) they committed significant resources to improvements of the premises to enable a fully licenced pre-school facility, and (b) Honey Bees and Mr James considered the second lift was important in achieving that enablement. In this context, a primary obligation to indemnify simpliciter would not secure the primary objective of the parties, namely premises that are fit for purpose. Rather, cl 2 is, to use the language employed by the Court of Appeal in *Torchlight*, a clause substituting one scale of performance for another designed to deter breach of the former.[58]

[62] The plaintiffs also submit the indemnity is a "conditional primary obligation" because cl 1:

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57 By email dated 18 December 2013 to Mr James, Mr Gilbert did however record "Denis to provide personal guarantee or something to make you happy".

58 *Torchlight*, above n 5, at [83].

(a) requires 127 Hobson to install a lift while cl 2 requires that the lift be fully operational;

(b) is not limited by time whereas cl 2 is; and

(c) is an agreement with 127 Hobson alone, whereas cl 2 is an agreement with both 127 Hobson and Mr Parbhu arising in the event the lift is not operational by 31 July 2016.

[63] There is force to this submission. But, to assess whether the penalty rule is engaged, substance comes before form. The listed factors do not change the essential character of cl 2 as a deterrent sanction for failure to install the lift on time. In short, the requirement at cl 2 for the lift to be operational by a specified time simply defines the point for breach, and, as expanded upon below, Mr Parbhu's liability is additional surety of performance and sanction in the event of default.

[64] The plaintiffs further contend the requirement to indemnify can never be a penalty because:

(a) An indemnity is a duty to make good any loss, damage or liability incurred by another.

(b) This duty presupposes that a loss has been, or will be, incurred by the party being indemnified.

(c) The fact the parties agreed to an indemnity shows it is a genuine pre-estimate of loss, and Honey Bees had a legitimate interest.

[65] Argument on this issue was relatively sparse. In any event, there are several problems with the plaintiffs' analysis. First, the plaintiffs' tautology misses the object of the penalty rule; it is engaged if the sanction, in this case the obligation to indemnify, is out of all proportion to the legitimate performance interests of the innocent party, or otherwise exorbitant or unconscionable, having regard to those interests. Any apparent consensus between the parties reflected in the terms of the agreement about the likely loss caused by breach is not determinative of this issue. Second, labels used

by the parties have never been a basis for avoiding characterisation as a penalty.[59] Finally, whether a party-party indemnity is the source of a secondary obligation to pay compensation for loss is a matter of construction.[60] As Carter and Courtney note, "[t]he adoption of an "indemnity" may indicate, in the sense the term was used by Asquith LJ in *Victoria Laundry*,[61] that the promise is to be protected against all loss flowing from breach, including loss that is unpredictable and improbable".[62] In this regard, for the reasons already expressed at above, I am satisfied the obligation to indemnify in the present case falls into this category.

[66] Accordingly, the penalty rule is engaged insofar as it concerns 127 Hobson.

(d) Does Mr Parbhu's indemnity clause engage the penalty rule?

[67] Clause 2 also literally imposes a conditional primary obligation on Mr Parbhu to indemnify Honey Bees and Mr James if the second lift is not installed by 31 July 2016. Furthermore, unlike 127 Hobson, there is no express obligation imposed on him to install the lift. At first blush therefore, Mr Parbhu's obligation to indemnify does not appear to correspond to a breach by him of any primary obligation and is not subject to the penalty rule. As noted by the House of Lords in *Export Credit Guarantee Department v Universal Oil Products Co*, a clause that provides for payment of money on the happening of a specified event other than a breach of a contractual duty "owed by the contemplated payor to the contemplated payee" is not a penalty clause.[63]

[68] However, read in context, I am satisfied for this part of the assessment Mr Parbhu's obligation to indemnify corresponds to the breach of an obligation owed by him. Mr Parbhu is the sole director of 127 Hobson and is identified by the Collateral Deed as the "guarantor" of 127 Hobson's obligations. The plaintiffs seek to attach Mr

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59 See *Cavendish*, above n 3, at [15], and *Dunlop*, above n 11, at 86.

60 J W Carter and Wayne Courtney "Indemnities against Breach of Contract as Agreed Damages Clauses" (2012) JBL 555 at 563 and 575-576. At 564, these authors note the difference between party-party indemnities and third party indemnities, where the latter is not usually concerned about an act of breach of contract, except perhaps as a stipulation.

61 *Victoria Laundry (Windsor) Ltd v Newman Industries Ltd* [1949] 2 KB 528 CA .

62 At 539. In *Burkard & Co Ltd v Wahlen* (1928) 41 CLR 508 (HCA), a majority found on the true construction of a contract for sale of tin clippings, a provision for indemnity in the event of default in delivery "shuts out" a claim in damages.

63 *Export Credit Guarantee Department v Universal Oil Products Co* [1983] 1 WLR 399 (HL) at 402. This decision was endorsed in New Zealand in *Marac Financial Services Ltd v Stewart* [1993] 1 NZLR 86 at 94.

Parbhu's guarantee to the indemnity, but in pre-contractual correspondence known to both parties, Mr James sought and Mr Parbhu accepted personal responsibility for installing the lift, not for indemnifying loss for non-performance.[64] As a result, Mr Parbhu is the "guarantor" insofar as he has provided a guarantee to secure installation of the second lift. In this sense, his obligation to indemnify is similar in concept to the obligation to pay in the defeasible bond cases.[65] As Lord Radcliffe noted in *Bridge v Campbell Discount Co Ltd*:[66]

> I do not see any sufficient reason why in the right setting a sum of money may not be treated as a penalty, even though it arises from an obligation that is essentially a guarantee.

[69] I am prepared therefore to approach the substantive assessment on the basis that Mr Parbhu's obligation to indemnify is secondary and engages the penalty rule.

(e) If the answer to (c) and or (d) is yes, is the obligation to indemnify a penalty?

[70] It is necessary to first define the extent of the obligation to indemnify. Clause 2 imposes an obligation on 127 Hobson and the Guarantor (Mr Parbhu) to "indemnify" for "all obligations" Honey Bees and Mr James may incur "under the Lease", including the payment of rent, without any apparent limit. While the plaintiffs presently seek only to enforce the obligation to indemnify rent and outgoings, the indemnity is not literally limited to these payments. As Mr Dillon submits, literally expressed, the obligation to indemnify includes rent payments, maintenance, breakages, painting, care of grounds, maintenance of waste and storm water, rubbish removal, notification of defects, use of premises, and compliance with statutes. Only cursory attention was given to this aspect of the case, but it defies common sense to suggest a landlord would, in indemnifying a lessees' obligations under the lease for late installation of a lift, include breaches of covenants relating to the use, maintenance

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64 This is not to suggest the corporate veil should be pierced. Rather the context shows that Mr Parbhu was inextricably part of the contractual matrix, including for the purpose of securing the second lift.

65 See *Sloman v Walter* (1783) 1 Bro CC 418 at 419. See also the discussion in *Andrews*, above n 4, at [11]; *Cavendish*, above n 3, at [4]-[5]. See also *AMEV-UDC Finance Ltd v Austin*, above n 31, at 190 per Mason and Wilson JJ.

66 *Bridge v Campbell Discount Co Ltd* [1962] AC 600 (HL) at 624, citing *Clydebank Engineering & Shipbuilding Co Ltd v Yzquierdo y Castaneda* [1905] AC 6 (HL) at 15.

and repair of damage. I therefore confine the scope of the indemnity to the Honey Bees to performance obligations to pay rent and outgoings.

[71] Second, the defendants claim the obligation to indemnify extends to the entire term of the lease including rights of renewal, that is 24 years. Whether renewal amounts to the grant of a fresh lease is a matter of construction in each case.[67] Mr Dillon submits on a proper construction of the Lease, each additional term is a variation not a renewal, and the distinction between the initial lease term and renewal terms is confined to cl 32.1, which need not be read into the Collateral Deed. I disagree. Clause 32.1 states:

> If the tenant has given to the Landlord written notice to renew the lease … then the landlord will grant a new lease for a further term from the renewal date as follows: …

[72] It resembles the clause discussed in *Sina Holdings*, in which the Court of Appeal found renewal constituted the grant of a new lease.[68] I see no reason to hold differently in relation to the present lease. That cl 32.1(c) provides the provisions of the Lease continue unchanged, a point made by Mr Dillon, does not displace the fact that on renewal, the Lease is a "new" lease. There is also nothing in the broader context to suggest Honey Bees, 127 Hobson, Mr James or Mr Parbhu agreed or had in mind an indemnity running for 22 years. Indeed, as with the suggestion that the indemnity extends to damage caused by the lessee to the premises, it is commercially absurd to suggest any of the contracting parties had this period in mind when they executed the Collateral Deed.[69]

[73] I also reject Mr Dillon's pleadings point. He contends the plaintiffs have not responded to the affirmative defence raised in the statement of defence, namely that the penalty ran for about 22 years. But, the plaintiffs' statement in reply denied (among other things) that the Collateral Deed contains a provision amounting to a penalty and that the terms of the penalty were unconscionable. This was sufficient to

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67 *Otehei Bay Holdings Ltd v Fullers Bay of Islands Ltd* [2011] NZCA 300, [2011] 3 NZLR 449 at [61].

68 *Sina Holdings Ltd v Westpac Banking Corporation* [1996] 1 NZLR 1 (CA).

69 Mr Parbhu first refers to the prospect of abatement in payments for 22 years in an email to Mr James on 25 October 2016. While Mr James does not disabuse Mr Parbhu of this prospect, nor does he purport to confirm it. It provides very weak evidence only that the parties contemplated an indemnity for this period.

put the defendants on notice that the penalty claim was challenged, particularly given the length of the indemnity is a question of mixed law and fact. In any event, had I thought it necessary to do so, I would have granted leave to the plaintiffs to amend their pleadings to make the necessary denial.

[74] I turn now to address the threshold issue, applying the principles summarised in *Torchlight*.

Is obligation to indemnify out of all proportion to the legitimate performance interests of the innocent party, or otherwise exorbitant or unconscionable, having regard to those interests?

[75] I have had the benefit of comprehensive submissions on this issue. They may be reduced to some core propositions. The plaintiffs contend at the time of execution installation of a second lift was important to the operation of a fully licenced childcare facility, and the constraints of having only one lift could have threatened their business' viability. It was therefore necessary to secure the installation of the second lift and mitigate the commercial risk arising from not having premises that were fully fit for purpose. Given the plaintiffs were liable for the full rental and outgoings, an indemnity corresponding to this liability was a reasonable deterrent against non-performance, particularly as the indemnity only equates to a reduction in rental and outgoings of less than 13 per cent over a potential 24-year arrangement.

[76] Mr Dillon colourfully responds that the indemnity is the "death" of the defendants' benefits under the Lease, and extravagant relative to any loss the plaintiffs could conceivably have incurred in the event of non-performance. He submits the claimed "existential" threat presented by non-performance is, in short, fanciful, because (a) the requirement for a second lift did not feature in the agreement to lease and (b) the facility has been fully licenced and operational since August 2015. He also says the indemnity does not incentivise performance at all, was never a proper basis for sanction, and is plainly punitive. To illustrate, he observes, had the lift been operational on 1 August 2016, the full force of the indemnity would apply – namely all obligations would be indemnified.

Assessment

[77] While the position is not clear cut, I am not satisfied the indemnity is out of all proportion to the plaintiffs' legitimate performance interests, or otherwise exorbitant or unconscionable, having regard to those interests. Clause 2 seeks to secure the installation of the second lift by 31 July 2016 and provides a legitimate substitute for non-performance. As submitted by the plaintiffs, multiple factors support this conclusion.

[78] Before I set these out, it is helpful to note that some of the *Dunlop* rules for assessing whether a clause was a penalty were not affected by the recasting in *Cavendish* and *Paciocco*. Key among these is the rule that whether a sum is a penalty is a question of construction to be decided upon the terms and inherent circumstances of each contract, judged at the time of the making of the contract, not at the time of the breach.[70] This is important because the present exercise is still concerned with what the parties intended, not what in fact transpired.

[79] Turning then to the proportionality factors; first, it is readily inferable from the words used in the Collateral Deed, and the broader context, the plaintiffs sought to secure and protect two related legitimate performance interests: (a) the installation of a second lift by a specified time and (b) leasehold premises that were fit for a fully licenced pre-school facility for the full leasehold period (including renewals). The plaintiffs also legitimately sought to insulate themselves from the commercial risk associated with premises which were not fully fit for purpose, in the event a second lift was not installed. In combination, these interests provided a proper basis for a secondary obligation to indemnify the plaintiffs' obligations under the Lease in the event of non-performance of the primary obligation to install.

[80] Second, the obligation to indemnify was only triggered if the lift was not installed by 31 July 2016, more than 31 months after the lease was executed. This afforded 127 Hobson ample opportunity to install the lift. This factor mitigates the

[70] *Dunlop*, above n 11, at 86-87 and Cavendish, above n 3, at [87].

apparent harshness of the scenario raised by Mr Dillion, namely an indemnity running to the expiry of the lease where the lift is installed on 1 August 2016.[71]

[81] Third, at the time of execution I find Mr Parbhu knew or should have known that:

(a) The second lift was important to the plaintiffs.

(b) The lift was (and is) important to the effective operation of a fully licenced facility because of the timing of drop off and pick up of children, the limited parking space available, and the location of the facility on the fifth floor of the building.

(c) Mr James and Honey Bees had expended significant resources on the fit out of the premises.[72]

(d) Honey Bees had a probationary licence for 24 children only.

(e) After 14 months, rental liability was to be fixed by reference to a fully licenced facility of 50 children and Honey Bees was liable to pay the full rent and outgoings, irrespective of the actual level of occupancy.

[82] These matters justified a strong deterrent against non-performance.

[83] Fourth, the likely losses arising from non-performance were not quantifiable at the time of execution, because the effect of non-performance was systemic; that is, it affects the fitness for purpose and attractiveness overall of the premises for a fully licenced childcare facility. Thus, any linkage between the absence of the second lift and financial losses is indirect only. This places the indemnity obligation into the fourth class of obligation identified in *Dunlop*, for which a comparison between the stipulated sum and likely loss is inapposite. This is also a factor favouring the conclusion that the indemnity was a genuine attempt at securing performance and a

71 I return to this issue below at [94].
72 Accounts provided by Honey Bees and provided to the Ministry of Education, adduced in evidence as Exhibit 1, put this figure at $600,000.

remedial solution to non-performance commensurate, in the view of the contracting parties, to plaintiffs' interests in performance. The impact of non-performance is also loosely akin to the type of systemic impact cl 5.1 of the agreement in *Cavendish* sought to protect against.[73]

[84] Additionally, I find both parties would have reasonably contemplated at the time of execution that by 31 July 2016:[74]

(a) The plaintiffs would have committed significant resources to the establishment of a viable and fully licenced facility, a client base and goodwill.

(b) The absence of a second lift could affect the plaintiffs' ongoing ability to efficiently and competitively operate a childcare facility at full capacity, and attract and keep clients – a point alluded to in pre-execution correspondence.[75]

(c) Any termination of the lease for non-performance (assuming Honey Bees could do so without incurring additional liability)[76] would have major consequences for the plaintiffs' business, including a potentially significant impact on goodwill.

(d) The plaintiffs had no viable way of securing a second lift without the defendants' cooperation, so alternative performance by the plaintiffs could be difficult, if not impossible.

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73 See [55] above. And in particular, see *Cavendish*, above n 3, at [143] per Lord Mance.

74 I have employed the remoteness tests adopted in *McElroy Milne v Commercial Electronics Ltd* [1993] 1 NZLR 39 (CA) at 43 per Cooke P and at 45 per Hardie Boys J for the assessment of potential impact.

75 The evidence on the effect of having only one lift, which I accept, included wait times of up to 20 minutes for a lift to arrive. The broader context to this is the other major tenant in the building is a hotel which places frequent demands on the use of the single lift, including at peak times for the childcare facility.

76 The lease expressly permits Honey Bees to cancel if regulatory conditions preclude a fully licenced operation at the premises. It does not expressly permit early termination for breach of cl 1 and or 2 of Collateral Deed.

[85] I disagree with Mr Dillon's submission that any "existential threat" to the plaintiffs' business arising from non-performance is not reflected in the pre-execution behaviour of the plaintiffs, or events after execution. I am satisfied Mr James sought confirmation a second lift would be installed at the time of the initial negotiations and then insisted on it immediately prior to execution, reflecting its importance to him. The subsequent success of the facility does not detract from the objective reasonableness of the plaintiffs' concerns about potential impact at the time of execution.[77] Conversely, the fact the lift was still not installed 14 months after the due date vindicates (in part)[78] the legitimacy of Mr James' concern.

[86] Fifth, both parties were commercially astute, Mr Parbhu particularly so. He is a very experienced property developer, managing some twelve commercial properties with a portfolio worth some [redacted]. He cannot be described as a person unduly vulnerable to commercial pressure. While there is evidence he was juggling his finances at the time of execution, this was not clearly made known to Mr James to an extent it could be deemed a disadvantage upon which he acted. I accept Mr Parbhu did not turn his mind to the precise terms of the indemnity at the time of execution, that it was not raised in pre-contract negotiations and that he did not receive independent legal advice about the effect of the Collateral Deed. This suggests a power imbalance and is a cause for concern. But these were self-imposed circumstances. Mr Parbhu could have sought his solicitor's advice, but he chose not to. He was content to rely on his own expertise in such matters, and he had good reason to do so given his extensive commercial property experience. In this context, there is no reason to depart from the axiom the parties can be presumed to be the best judges of their interests.

[87] Sixth, I am satisfied the predominant purpose of the indemnity was not to punish non-performance. In addition to the purposes already mentioned, the plaintiffs had good reason to doubt the reliability of the defendants' ability to install the second lift on time and therefore equally good reason to seek to deter non-performance in strong terms. Mr James' experience with Mr Parbhu was marred by the misleading

[77] Cf *Philips Hong Kong Ltd v Attorney-General of Hong Kong* (1993) 61 BLR 41 (PC) at 59 for the reverse proposition that what transpired indicated the clause was not in fact punitive.

[78] See my discussion below regarding relief against forfeiture.

nature of the advertisement for the 127 Hobson Street premises and ongoing problems with securing premises that were fit for purpose throughout the pre-lease set up period. A salient example is the handling of car parking issues. Mr Parbhu assured Mr James the facility would have access to a specified number of carparks. He forwarded an email to Mr James sent by Auckland City Council. Mr James later discovered Mr Parbhu had edited the email to exclude comments by the Council which appeared to place the availability of the parks in doubt. This exacerbated Mr James' existing concerns about Mr Parbhu's trustworthiness and reliability.[79]

[88] Finally, I have considered the potential consequences of non-performance against the estimated cost of the indemnity to Mr Parbhu and/or 127 Hobson. The cost to the defendants is substantial: $556,578.83 or about 60 per cent of the lease payments to expiry. In addition, there is the estimated cost of the installation of $222,940.[80] A relatively trifling breach of cl 2 therefore exposed 127 Hobson and Mr Parbhu to, effectively, forfeiture of all their performance consideration from the date of breach to the expiry of the first lease.[81]

[89] This is the defendants' strongest point. It was a decisive factor in two comparable cases: *Hills* and *Gilbert Ash*.[82] In those cases remedial clauses enabled the non-breaching party to withhold payments for works either not completed on time or not compliant with contract standards. The complete lack of any correspondence between the losses arising on trivial breaches and the stipulated amounts rendered the relevant provisions unenforceable.

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79 Despite the validity of Mr James' concerns, I accept Mr Parbhu did not intend to mislead, either in respect of the advertisement, or on the parking issues. He had independent expert advice as to the suitability of the premises for the purpose of the advertisement. Furthermore, I accept Mr Parbhu's explanation that he edited the email to avoid causing undue concern rather than to mislead. He had a very clear appreciation of the rights to carparking which ultimately have been proven to be correct.

80 This sum was not produced in evidence. Rather, it was provided by counsel for the defendants in response to a specific question I asked to be addressed in closing submissions. It was not contested by counsel for the plaintiffs in their reply submissions.

81 In this regard, I reject the plaintiffs' quantification of the relative impact by reference to the 24-year rental and outgoings sum. I am not prepared to infer the parties had this sum in mind at the time of execution.

82 See *Commissioner of Public Works v Hills*, above n 2, at 375-376 and *Modern Engineering (Bristol) Ltd v Gilbert Ash (Northern) Ltd* [1974] AC 689 (HL) at 698. See also *Cavendish*, above n 3, at [253]-[254] per Lord Hodge.

[90] Similarly, their Lordships in *Bridge* unanimously concluded a stipulated sum payable upon early cancellation, purportedly as agreed compensation for depreciation and amounting to two thirds of the full hire cost, was a penalty.[83] Lord Radcliffe acknowledged an owner may legitimately seek to protect himself against having "goods, part-worn and of uncertain realisable value, thrown back on his hands, with the attendant difficulty of putting any satisfactory second-hand value on them for the purposes of proving his damage".[84] But he doubted whether the owner could "protect himself on the scale of up to two-thirds that is envisaged here, without much more elaborate provisions for adjustment according to the circumstances in which the claim falls due."[85]

[91] This reasoning was echoed by the High Court of Australia in *O'Dea*. It set aside a clause purporting to require the hire-purchaser of a truck to pay all instalments to the end of the hire period even though the truck had been repossessed early. Deane J commented, in concluding the stipulated sum was a penalty, that the clause removed all the hire-purchaser's consideration for trivial breach, while at the same time conferring all the benefits of the agreement to the hirer.[86] Smellie J reached the same conclusion in similar circumstances in *Melrose*. He stated that the remedial clause was a penalty because: [87]

> In the circumstances of this case the facts show clearly that if the provisions of cl 15 are applied the plaintiff will recover significantly more as a result of the defendant's default than it would have recovered had the agreement run its course.

[92] Nevertheless, the plaintiffs in the present case executed the Lease on the assumption that by 31 July 2016 the premises would have two lifts, not one. It was a major prerequisite to the plaintiffs entering and committing to a long-term leasehold. The date for implementation was not a target to be hit, but a compromise beyond which a remedy would be demanded. As noted, at the time of execution, the parties should reasonably have contemplated that non-performance could have a significant,

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83 Viscount Simonds dissented on the result because of a pleading point, but otherwise agreed that the stipulated sum in cl 9(b), the focus of the other judgments, was a penalty.
84 At 625.
85 At 625.
86 At 400-401. See also the judgments of Gibbs CJ at 369, Murphy J at 375, and Wilson J at 383.
87 *General Finance Acceptance Ltd v Melrose*, above n 2, at 470.

ongoing, systemic impact on the overall functioning and viability of the childcare facility. Furthermore, it is relevant that but for the indemnity the plaintiffs were exposed to full rental and outgoings liability even if they were not operating at full capacity, and with or without the installation of the second lift. In this context, unlike the facts in *Hills*, *Gilbert Ash*, *Bridge or O'Dea*, the plaintiffs continued to assume the ongoing commercial risk of occupying premises that were not, in their minds, fit for purpose. The effect of the indemnity was to reallocate that risk to the defendants. This should have been obvious to the parties at the time of execution, even though I accept Mr Parbhu did not specifically turn his mind to it. Accordingly, there was, at the time of execution, a sufficient relationship between the indemnity against lessee liability and the legitimate performance and commercial interests of the plaintiffs.

[93] These facts also bring this case into closer alignment with the facts in *Cavendish* and *ParkingEye*. In the former, protection of performance interests justified a strong deterrent clause (and significant price adjustment) to account for unquantifiable impacts of a breach of the restraint of trade on goodwill.[88] In *ParkingEye*, a substantial sum was payable for overstaying, well in excess of the actual cost of parking, because of the systemic effect on the plaintiff of such overstaying.[89] Furthermore, the plaintiffs in the present case were not interested in recovering a sum reflecting economic losses. They clearly wanted to establish and maintain a long term viable childcare centre, for which they saw the installation of the lift as a key component.

[94] I also draw assistance from *Philips*, a decision of the Privy Council. That case concerned a purported liquidated damages clause, the effect of which meant that a subcontractor might be liable for a sum which could be wholly out of proportion to any loss for a hypothetically minor breach of the contract. In declining to accept this hypothetical scenario, the Privy Council stated, relevantly: [90]

> Whatever the degree of care exercised by the draftsman it will still be almost inevitable that an ingenious argument can be developed for saying that a particular hypothetical situation a substantially higher sum will be recovered than would be recoverable if the plaintiff was required to prove his actual loss in that situation. Such a result would undermine the whole purpose of parties

88 *Cavendish*, above n 3, at [75].
89 At [99]. See also *Robophone Facilities Ltd v Blank* [1966] 1 WLR 1428 (CA).
90 *Philips*, above n 77, at 54.

> to a contract being able to agree beforehand what damages are to be recoverable in the event of breach of contract.

[95] Finally, as I will explain below, the response to the type of unconscionability identified in *Hills*, *Gilbert Ash, Bridge* and *O'Dea* may be better framed in terms of equitable relief against forfeiture.[91]

[96] Stepping back from the detail, it is not the function of the law of penalties to protect commercially sophisticated property investors from their commercial decisions. The facts and conclusion in *Export Credits Guarantee Department* exemplifies the point. In that case, several multilateral contracts were concluded between three companies. One of the contracts involved a construction project to be completed by the third defendants. Finance was partially effected by an arrangement whereby the companies issued promissory notes to mature on specified dates in return for bank funds, which were used to pay the third defendant. Payment on the promissory notes was guaranteed by the plaintiffs subject to a proviso (cl 7(1)) that the defendants would reimburse the plaintiffs if the promissory notes were dishonoured at a time the defendants were in breach of the contracts, including the construction contract. Some of the promissory notes were dishonoured, and the plaintiffs claimed £39,571,001.54 in payments made under the guarantee, as the third defendant was in default under the construction contract at the time. The defendants claimed the indemnity clause was a penalty.

[97] The House of Lords rejected the penalty claim. Lord Roskill stated:[92]

> … the law relating to penalty clauses is to prevent a plaintiff recovering a sum of money in respect of a breach of contract committed by a defendant which bears little or no relationship to the loss actually suffered by the plaintiff as a result of the breach by the defendant. But it is not and never has been for the courts to relieve a party from the consequences of what may in the event prove to be an onerous or possibly even a commercially imprudent bargain.

[98] His Lordship emphasised that on the facts the plaintiffs were doing no more than claiming their actual losses, so the clause could never amount to a penalty. This

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91 Notably, Brennan J in *O'Dea* at 391 preferred to frame the central issues in terms of equitable relief against forfeiture. See also discussion in *Cavendish*, above n 3, at [17] per Lords Neuberger and Sumption, [160]-[161] per Lord Mance, and [226]-[229] per Lord Hodge.

92 *Export Credit Guarantee Department v Universal Oil Products Co*, above n 63, at 403.

is a distinguishing factor. But for the reasons set out above, I remain satisfied therefore that the penalty rule, while engaged, ought not be applied in this case.

[99] Accordingly, overall, I am satisfied the obligation to indemnify is not out of all proportion to the legitimate performance interests of the plaintiffs, or otherwise exorbitant or unconscionable, having regard to those interests. Given this, I have not found it necessary to consider what alternate relief is appropriate.

Was the Collateral Deed executed in circumstances that were unconscionable?

[100] The plaintiffs allege unconscionable bargain has not been pleaded as an affirmative defence. But all aspects of the unconscionability claim needed to be and were addressed in any event. Additionally, while far from perfect, I am satisfied the statement of defence adequately pleaded the necessary elements of unconscionable bargain:[93]

(a) The party seeking relief must have been suffering under a significant disability or disadvantage at the time they entered into the bargain. A qualifying disability is a characteristic or condition which significantly diminishes a party's ability to assess his or her best interests. Stress or anxiety may qualify.

(b) If a qualifying disability or disadvantage is proven, the essential question is whether in the particular circumstances it is unconscionable to permit the stronger party to take the benefit of the bargain. This requires:

(i) knowledge (including constructive knowledge, which may among other things be established from the substance of the transaction or the way it was concluded) of the weaker party's disability or disadvantage; and

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93 See *Gustav & Co Ltd v Macfield Ltd* [2007] NZCA 205 at [30] for a full statement of relevant principles. These principles were endorsed on appeal in *Gustav & Co Ltd v Macfield Ltd* [2008] NZSC 47, [2008] 2 NZLR 735 at [6].

(ii) that the stronger party took advantage of that disability, either by active extraction or passive acceptance of a benefit.

[101] I therefore prefer to deal with the merits. Mr Dillon submits that the orthodox requirements for unconscionability are met:[94]

(a) Qualifying disability – Mr Parbhu was under significant financial pressure at the time he entered into the Collateral Deed and did not receive legal advice.

(b) Mr James knew about this disability.

(c) The knowledge was used to extract an advantage that would be unconscionable to allow to stand, namely the indemnity obligation in cl 2.

[102] This claim fails at several points. First, I am not satisfied Mr James knew about Mr Parbhu's financial pressures to the extent it bears on the conscionability of the bargain. He was plainly aware Mr Parbhu wanted to finalise the Lease and that he was under financial pressure. The imbalance in consideration in the Collateral Deed and the haste with which Mr Parbhu entered into it are factors to be considered, but Mr James was not aware of the detail of Mr Parbhu's financial circumstances; in fact from his perspective he was entered into a Lease agreement with a highly successful commercial property owner/manager. Second, Mr Parbhu insisted on using Mr James' solicitors to draft the agreements, because as an experienced and sophisticated owner/manager of commercial property, he did not feel the need to retain legal advice. Any vulnerability arising was therefore due to Mr Parbhu's decision making, and has nothing to do with Mr James. It is also relevant the agreements were sent through Mr Gilbert, Mr Parbhu's business broker. Mr Parbhu was not without access to independent advice.[95]

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94 See also discussion in Butler, above n 35, at [23.1.2].

95 A similar conclusion with similar facts was reached in *Walmsley v Christchurch City Council* [1990] 1 NZLR 199 at 207.

[103] Third, there is nothing to suggest Mr James intentionally relied on any disability to extract an advantage. In this regard, Mr Dillon notes there was no obligation under the agreement to lease to include the collateral obligations, and the somewhat frantic circumstances of leading up to execution. But these factors fall well short of demonstrating an intention on Mr James' part to take advantage of Mr Parbhu's disability, even in the form of passive acceptance of a benefit.

[104] This claim therefore fails. I pause however to note that the very late inclusion of an indemnity, without any warning to Mr Parbhu about it, raises distinct fairness concerns. Had Mr Parbhu been a less sophisticated party in commercial property matters, and the period to install less generous, a case for unconscionable bargain may well have succeeded.

Relief

[105] The plaintiffs seek and are entitled to specific performance of the obligation to indemnify to the date of installation of the second lift. That much is clear. I reserve my position however in relation to specific performance beyond that date. The rule against penalties has been the focus of this proceeding. Equitable relief against forfeiture was not sought or argued. But with the benefit of close examination of the law in this area and the facts, it is tolerably clear to me that this is a case where equitable relief against forfeiture should be considered.

[106] Importantly, Lord Mance and separately Lord Hodge, with whom the rest of the Court largely agreed,[96] emphasised the conceptual difference between the penalty rule and equitable relief against forfeiture. Lord Mance stated:

> [160] *Jobson v Johnson* [1989] 1 WLR 1026 proceeds on the basis that a case may raise for consideration both the penalty doctrine and the power of the court to relieve against forfeiture. In my opinion, that is both logical and correct in principle under the current law. A penalty clause imposes a sanction for breach which is extravagant to the point where the court will in no circumstances enforce it according to its terms. The power to relieve against forfeiture relates to clauses which do not have that character, but which none the less operate on breach to deprive a party of an interest in a manner which would not be penal. That it would not be penal is evident from the fact that the court will only grant relief on the basis that the breach is rectified by

96 *Cavendish*, above n 3, at [291] per Lord Clarke, [294] per Lord Toulson and at [10] and [18] per Lords Neuberger and Sumption.

> performance. "In the ordinary course", as the Privy Council said in *Çukurova Finance International Ltd v Alfa Telecom Turkey Ltd (No 4)* [2016] AC 923, 979, para 13, "relief in equity will only be granted on the basis of conditions requiring performance, albeit late, of the contract in accordance with its terms as to principal, interest and costs: see eg per Lord Parker of Waddington in *Kreglinger (G & C) v New Patagonia and Cold Storage Co Ltd* [1914] AC 25, 49–50 and per Lord Wilberforce in *Shiloh Spinners Ltd v Harding* [1973] AC 691, 722c, 723h." The two doctrines, both originating in equity, therefore operate at different points and with different effects. Consideration whether a clause is penal occurs necessarily as a preliminary to considering whether it should be enforced, or whether relief should be granted against forfeiture.

[107] Similarly, Lord Hodge noted:

> [227]. Cavendish has argued that such clauses should be seen as forfeiture clauses to which the law of penalties should not apply. Ms Smith urged that it would be a recipe for confusion if a single clause were to be classified in two different ways. I disagree. There is no reason in principle why a contractual provision, which involves forfeiture of sums otherwise due, should not be subjected to the rule against penalties, if the forfeiture is wholly disproportionate either to the loss suffered by the innocent party or to another justifiable commercial interest which that party has sought to protect by the clause. If the forfeiture is not so exorbitant and therefore is enforceable under the rule against penalties, the court can then consider whether under English law it should grant equitable relief from forfeiture, looking at the position of the parties after the breach and the circumstances in which the contract was broken. This was the approach which Dillon LJ 1271adopted in *BICC plc v Burndy Corpn* [1985] Ch 232 and in which Ackner LJ concurred. The court risks no confusion if it asks first whether, as a matter of construction, the clause is a penalty and, if it answers that question in the negative, considers whether relief in equity should be granted having regard to the position of the parties after the breach.

[108] Significantly also for present purposes, Lords Neuberger and Sumption noted that relief from forfeiture was not confined to cases about forfeiture of land. They stated:[97]

> Where a proprietary interest or a "proprietary or possessory right" (such as a patent or a lease) is granted or transferred subject to revocation or determination on breach, the clause providing for determination or revocation is a forfeiture and cannot be a penalty, and, while it is enforceable, relief from forfeiture may be granted: see *BICC plc v Burndy Corpn* [1985] Ch 232, 246–247, 252 (Dillon LJ) and *The Scaptrade* [1983] 2 AC 694, 701–703 (Lord Diplock). But this does not mean that relief from forfeiture is unavailable in cases not involving land: see *Çukurova Finance International Ltd v Alfa Telecom Turkey Ltd (No 3)* [2016] AC 923, especially at pp 956–957, paras 92–97, and the cases cited there.

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97 At [17].

[109] The Court of Appeal in *Greenshell* recently laid out the applicable criteria for equitable relief from forfeiture. For present purposes, it is only necessary to refer the following passage:[98]

> The paradigm case for relief is where the primary object of a bargain is to secure a stated result which can be effectively attained when the matter comes before the court, and where the forfeiture provision is added by way of security for the production of the result.

[110] In the present case, 127 Hobson must, in effect, forfeit all rental and outgoing payments and corresponding secondary rights of enforcement for non-payment. While the form of the forfeiture is indirect, in substance that is what cl 2 achieves. To illustrate, 127 Hobson has effectively lost the landlord's right to re-enter the property for breach of the covenant to pay rent.[99] In the result, the indemnity derogates from rights that are proprietary in nature.[100] Crucially, it also carries the most distinctive feature of clauses the doctrine classically provides relief against: it is designed as security of a primary stipulation. For my part, it is therefore arguable that in the circumstances of this case, equitable relief against forfeiture of the rental and outgoings following the installation of the second lift would be appropriate. As Brennan J stated in *O'Dea*:[101]

> Equity may mould a decree relieving against the exaction of a forfeiture under such a stipulation according to the exigencies of the case, as Jacobs J said in *Forestry Commission of NSW v Stefanetto*: "A court of equity can mould its relief so that the substantial purpose of its doctrine of relief against forfeiture … is achieved.

[111] This outcome would vindicate and protect the plaintiffs' performance interests considering the circumstances that have in fact unfolded, while preserving 127 Hobson's residual performance interests under the Lease. It would address the type of unconscionability underpinning the outcomes in *Hills*, *Gilbert Ash, Bridge* and

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98 See *Greenshell NZ Ltd (in rec) v Kennedy Bay Mussel Co (NZ) Ltd* [2015] NZCA 374, [2016] 2 NZLR 44 at [44] (footnotes omitted).

99 Property Law Act 2007, ss 244-245.

100 While equitable relief appears not to be limited to cases involving land, the prevailing orthodoxy is that the relief attaches only to possessory rights. See *Scandinavian Trading Tanker Co AB v Flota Petrolera Ecuatoriana (The Scaptrade)* [1983] 2 AC 694 (HL) at 702. See also *Çukurova Finance International Ltd v Alfa Telecom Turkey Ltd (No 3)* [2016] AC 923. It will be a matter for full argument, but my preliminary view is that the obligation to indemnify derogates from the landlord's various rights of entry and possession for non-payment of rent.

101 *O'Dea*, above n 2, at 392, citing *Forestry Commission of NSW v Stefanetto* (1976) 133 CLR 507 (HCA).

O'Dea. It is also the type of relief endorsed in *Jobson*, though in that case under the rubric of the penalty doctrine. My preliminary view therefore is that this is logical point for the intervention of this Court to avoid an apparently unconscionable result. Two additional comments are necessary:[102]

(a) If relief against forfeiture was granted in respect of 127 Hobson, relief for Mr Parbhu's indemnity would likely follow. As Brennan J stated in *O'Dea*:

> The principle stated by Rich J in *McDonald v Dennys Lascelles Ltd* as to a guarantor's liability for instalments of the purchase price under a contract of sale of land is no less applicable to the guarantor's liability for that part of the entire rental which is attributable to the hiring period after repossession. Richard J said: "Once it is decided, as upon the authority of *Mayson v Clouet*, I think it must be decided, that as between purchaser and vendor the vendor cannot retain, let alone recover, an overdue instalment of purchase money after the contract has come to a premature end even by his own fault, I think it follows that no guarantee of such an instalment could be enforced by the vendor.

(b) Unlike the penalty rule, the conduct of the party seeking relief is relevant under the equitable doctrine of relief against forfeiture. Nothing I say here should be seen as a final comment on the grant of relief.

[112] Given that the availability of equitable relief from forfeiture was not argued, I grant leave to the parties to be heard on this issue before making orders for specific performance in relation to the periods following installation of the second lift.

Outcome

[113] The plaintiffs' claim is successful. 127 Hobson and/or Mr Parbhu must indemnify the plaintiffs for rental and outgoings to the date of installation of the second lift.

[114] If agreement cannot be reached, I reserve leave to the parties to be heard on relief for the period following installation. Memoranda in this regard are to be filed,

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102 *O'Dea*, above n 2, at 394 (footnotes omitted).

within 15 working days, together with submissions on costs. I expect costs submissions to be succinct, given (a) the presumption that costs follow the event and (b) the cost principles ordinarily applicable to grants of equitable relief from forfeiture.[103]

[103] See *Mulholland v Waimarie Industries Ltd* (2009) 10 NZCPR 590.

1. PREMISE: 127 Hobson Street, Auckland comprising the whole of Level 5

2. CAR PARKS: 5 pickup and drop off car parks in Pacific Parade [no permanent car parks]

3. TERM: Six (6) years

4. COMMENCEMENT DATE: the date of this Deed

5. RIGHTS OF RENEWAL: Three (3) rights of renewal for six (6) years each

6. RENEWAL DATES: the 6th, 12th and 18th anniversaries of the date of this Deed

7. FINAL EXPIRY DATE: 24 years less one day from the date of this Deed

8.	ANNUAL RENT:	Premise $145,600 plus GST
	(Subject to review if applicable)	Car Parks $- plus GST
		TOTAL$145,600 plus GST
9.	MONTHLY RENT:	$12,133.33 plus GST
10.	RENT PAYMENT DATES:	One month from the date of this Deed and the same day of each month thereafter
11.	RENT REVIEW DATES:	1. Market rent review dates:
	…	2. CPI rent review dates:
		On the sixth anniversary of the date of this Deed and annually thereafter

…

16.	PROPORTION OF OUTGOINGS	pro rata based on floor area % which at commencement date is estimated to be $19709.27 plus GST per annum