CCRC by effectively directing applicants away from judicial review proceedings against the police and CPS if they have not taken their case to the CCRC.

In practice, the implications of the decision may be fairly modest. The Court has confirmed that the right to access material after a failed appeal is limited and certainly a more restricted right than that afforded to a defendant facing trial. It has sought to discourage requests that are speculative, but expressed the hope that prosecution authorities will cooperate with well-targeted requests for access that offer a "real prospect" of success. The role of the CCRC is unlikely to change much either. It already rejects applications that are speculative fishing expeditions, so once again a well-targeted application will be crucial.

Applicants will still face a significant hurdle in persuading the CCRC to review a case, because of the emphasis which the CCRC places on the statutory requirement that a referral should normally be based on some evidence or argument not put forward at trial or appeal. The catch-22 problem for applicants is that they may be unable to furnish the CCRC with sufficient fresh evidence or argument to secure a full review of their case precisely because they cannot gain access to the material that might enable them to do so.

It also seems legitimate to ask whether the finality of proceedings should be afforded greater weight than correcting a miscarriage of justice. Surely finality is much more satisfactory if the correct outcome is achieved.

STEPHEN HEATON

LOST ON PENALTIES

FREEDOM of contract is a fundamental principle of English law, but it is of course qualified by numerous protective regimes, some common law, most statutory nowadays, which protect vulnerable parties from untrammelled, unequal free bargaining. It is, quite rightly, exceptional for an experienced commercial party, negotiating at arm's length and with the benefit of specialist professional advice, to succeed in invoking such a regime to escape being bound by what he freely agreed. Yet, in *Cavendish Square Holdings BV v Makdessi* [2013] EWCA Civ 1539, this was precisely the controversial result.

The defendant Makdessi, founder of the largest advertising and marketing communications group in the Middle East, contracted in 2008 to sell his majority shareholding in the group's holding company ("the company") to the claimant, Cavendish. The agreed contract price, which included significant sums reflecting the goodwill of the company, was to be paid by instalments: most was paid on completion of the agreement, but two remaining

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instalments were deferred and were to be calculated by reference to a complex formula involving the company's operating profit after tax.

The agreement included a clause, headed "Protection of Goodwill", which contained restrictive covenants given by the defendant prohibiting him from competing with the business of the company. The judge at first instance held that these restrictive covenants were not in unreasonable restraint of trade and were thus valid, and there was no appeal against that finding. Crucially, the agreement also provided adverse consequences if the defendant breached these restrictive covenants, of which the most significant (contained in clause 5.1) was that he would not be entitled to receive the remaining instalments of the contract price and Cavendish's obligations to make those payments "shall cease".

In 2010, the defendant was found to be in breach of these restrictive covenants against competition: he had continued to provide services to a rival company and had set up rival advertising businesses in Lebanon and Saudi Arabia, which had attempted to poach some of the company's customers and employees. Cavendish sued the defendant for breach of contract and declined to pay the remaining instalments of the price, which amounted to over $40 million. Importantly, the company itself also sued him for breach of fiduciary duty, based on the fact that initially he remained a non-executive chairman and director of the company so, by competing with it, he was in clear breach of fiduciary duty. The defendant conceded one limited allegation of competition and settled the company's claim out of court for $500,000. But he strongly resisted Cavendish's action and, in particular, pleaded that clause 5.1 was unenforceable as a penalty. The judge at first instance disagreed, so the defendant appealed to the Court of Appeal, which unanimously allowed the appeal.

Christopher Clark L.J. gave the only substantive judgment. He began by reviewing the authorities on when liquidated damages clauses will be construed as penal and thus unenforceable, inevitably beginning with Lord Dunedin's famous presumptions from *Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd* [1915] A.C. 79, of which the first is that a clause will be held to 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 the breach". Although this remains the nub of the enquiry today, modern cases have shifted the emphasis slightly, so that the comparison between the sum stipulated and the greatest conceivable loss is seen as an aspect of the question of "whether at the time the contract was entered into the predominant contractual function of the provision was to deter a party from breaking the contract or to compensate the innocent party for the breach" (Colman J., in *Lordsvale Finance Bank plc v Bank of Gambia* [1996] Q.B. 752). More recently, in *Murray v Leisureplay* [2005] EWCA Civ 963, Buxton L.J. (with whom Clarke L.J. agreed) emphasised that the burden of proving

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that a clause is a penalty is an onerous one – a court will not interfere lightly with the parties' bargain, but only where it is "extravagant or unconscionable" – which requires enquiring more generally whether there might be good commercial reasons for stipulating for a payment that was much greater than the potential loss.

Christopher Clark L.J. in *Makdessi* embarked on the analysis of clause 5.1 with the familiar warning that a court should "not be astute to find that a clause contained in a commercial contract is unenforceable because it is penal, especially if the parties are of equal bargaining power and have had high level legal advice" but added that commercial parties were not "immune" from the reach of the penalty doctrine. Following Buxton L.J. in *Murray v Leisureplay*, he approached the issue in two stages.

First, he asked whether the clause was a genuine pre-estimate of Cavendish's loss, and held it was not, for two distinct reasons. One was that there was no "proportionate relationship" between the impact of the breach (which might be trifling or very short-lived) on Cavendish and the sum (over $40 million) forfeited by the defendant. The other reason was a technical company law principle known as "reflective loss": because there is risk of double recovery if a company suffers a loss, which in turn reduces the value of its shares so its shareholders suffer loss as well, the courts have developed the rule that, if the same defendant is liable to both, the shareholder cannot sue but only the company can (see e.g. the House of Lords decision *Johnson v Gore Wood & Co* [2001] 1 All E.R. 481). This principle was triggered in *Makdessi*: "When the Agreement was made Cavendish's damages for breach of the restrictive contracts were likely to be zero because they would be damages for the loss of the value of their shareholding and thus reflective of a loss to the Company itself."

So, putting these two factors together, Christopher Clark L.J. held that clause 5.1 was not a genuine pre-estimate of loss. However, since this is no longer regarded as conclusive, he then turned to the second issue – whether there was nonetheless any commercial justification for the clause – and concluded that there was not:

> Their effect is that Mr Makdessi stands likely to forfeit sums in the tens of millions in circumstances where, because of the unacceptability of double recovery, the law, for reasons of public policy, precludes any recovery by Cavendish at all …. These consequences occur upon the first, not necessarily material, breach … when the range of activities which may amount to breach and of their possible consequences is likely to be very wide and to fall into different categories of seriousness …. This seems to me to go way beyond compensation and into the territory of deterrence.

So the clause could only be an attempt to deter breach, and was thus penal and unenforceable. This result is extremely problematic, for a

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number of reasons. First, one of the many benefits of liquidated damages clauses (and analogous clauses such as clause 5.1) is that they spare the parties the uncertainties of arguments over quantum and, more pertinently, spare claimants the problem that many forms of loss are irrecoverable as being too remote or simply of an impermissible type. Traditionally, then, when considering whether such a clause is a genuine pre-estimate of loss or a penalty, the courts have looked at the *total* potential loss at the time contract is made, not just loss which actually occurs or which is legally recoverable. The controversial reflective loss principle – which here left the shareholder unable to recover any part of its multi-million-dollar loss of goodwill caused by the defendant's breach of contract because of the coincidence that the company suffered a small loss caused by a breach of fiduciary duty – should be treated in the same way. How else could Cavendish protect itself and the value of its shareholding from the defendant's wrongful and damaging competition, other than by a provision such as clause 5.1? (Some background is revealing here: Cavendish has been given permission to commit the defendant for contempt of court in respect of lies about his competing activities contained in his pleadings, and the Court of Appeal refused the defendant leave to appeal against this.)

But the problems with the Court of Appeal's decision are more fundamental than merely the result on the facts. The decision departs from the courts' usual approach to liquidated damages clauses negotiated at arm's length in commercial agreements between informed, professionally advised parties, which is to respect freedom of contract and to be very wary indeed of condemning such clauses as penalties (see e.g. *Phillips Hong Kong Ltd. v Attorney General of Hong Kong* (1993) 61 Build L. R. 41). Moreover, the common law penalty jurisdiction originally protected against oppression of weaker parties, but the Unfair Terms in Consumer Contracts Regulations 1999 now gives relief against unfair penalties in consumer contracts. Do we need to retain the common law jurisdiction elsewhere?

The most fundamental question, however, is simply never asked. That is, what is wrong with allowing arm's length commercial parties to agree to deter breach? English law is often accused of giving too much weight to a contract-breaker's right to pay damages instead of perform, and correspondingly too little protection of the innocent party's performance interest, so why not let parties agree a regime that redresses that balance? Perhaps the Supreme Court will provide the answer, when Cavendish's appeal is heard next year.

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