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DUNLOP PNEUMATIC TYRE CO LTD V NEW GARAGE MOTOR CO LTD

FACTS

Dunlop Pneumatic Tyre Co Ltd ('Dunlop') entered into a contract to sell tyres and other accessories to New Garage Motor Co Ltd ('New') on terms design to ensure that the tyres were not sold below the manufacturers listed price. New agreed to pay Dunlop "the sum of £5 for each and every tyre ... sold in breach of this agreement, as and by way of liquidated damages and not as a penalty". New sold tyres in breach of the agreement.

ISSUE

Whether the clause constituted a penalty and, consequently, was unenforceable.

FINDING

In the circumstances of the case, the sum of £5 was a liquidated damage and not a penalty.

QUOTE

Lord Dunedin in his classic statement of liquidated damages said, at paragraphs 86 to 88:

"Though the parties to a contract who use the words 'penalty' or 'liquidated damages' may prima facie be supposed to mean what they say, yet the expression used is not conclusive. The Court must find out whether the payment stipulated is in truth a penalty or liquidated damages. This doctrine may be said to be found passim in nearly every case. The essence of a penalty is a payment of money stipulated as in terrorem of the offending party; the essence of liquidated damages is a genuine covenanted pre-estimate of damage (Clydebank Engineering and Shipbuilding Co v Don Jose Ramos Yzquierdo y Castaneda [1905] AC 6. The question whether a sum stipulated is penalty or liquidated damages is a question of construction to be decided upon the terms and inherent circumstances of each particular contract, judged of as at the time of the making of the contract, not as at the time of the breach (Public Works Commissioner v Hills [1906] AC 368 and Webster v Bosanquet [1912] AC 394.

To assist this task of construction various tests have been suggested, which if applicable to the case under consideration may prove helpful, or even conclusive. Such are: It will be held to be penalty if the sum stipulated for is extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from the breach. (Illustration given by Lord Halsbury in Clydebank Case [1905] AC 6.) It will be held to be a penalty if the breach consists only in not paying a sum of money, and the sum stipulated is a sum greater than the sum which ought to have been paid (Kemble v Farren 6 Bing 141). This though one of the most ancient instances is truly a corollary to the last test. Whether it had its historical origin in the doctrine of the common law that when A promised to pay B a sum of money on a certain day and did not do so, B could only recover the sum with, in certain cases, interest, but could never recover further damages for non-timeous payment, or whether it was a survival of the time when equity reformed unconscionable bargains merely because they were unconscionable, - a subject which much exercised Jessel MR in Wallis v Smith 21 Ch D 243 - is probably more interesting than material.

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There is a presumption (but no more) that it is penalty when 'a single lump sum is made payable by way of compensation, on the occurrence of one or more or all of several events, some of which may occasion serious and others but trifling damage' (Lord Watson in Lord Elphinstone v Monkland Iron and Coal Co 11 App Cas 332).

On the other hand:

It is no obstacle to the sum stipulated being a genuine pre-estimate of damage, that the consequences of the breach are such as to make precise pre-estimation almost an impossibility. On the contrary, that is just the situation when it is probable that pre-estimated damage was the true bargain between the parties (Clydebank Case, Lord Halsbury [1905] AC at p11; Webster v Bosanquet, Lord Mersey [1912] AC at p 398."

IMPACT

The use of the words 'penalty' or 'liquidated damages' does necessary mean that a clause is either a 'penalty' or a 'liquidated damages' clause. The Court will review the clause in light of the circumstances at the time of entering into the Contract. [1915] AC 79

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