FORFEITURE, PENALTIES AND DAMAGES IN PROPERTY LAW

The 8th Annual Property Law Lecture at the School of Law and Social Justice in the University of Liverpool

given by Mr Justice Fancourt, Vice-Chancellor of the County Palatine of Lancaster

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1. This lecture is mainly about the nature of forfeiture and the jurisdiction to relieve against forfeiture. However, it considers the boundaries of the law of forfeiture rather than the core law that applies, for example, in the context of landlord and tenant law. What is a forfeiture, and how far the jurisdiction to relieve against forfeiture extends, are questions that the Supreme Court has had to address in two recent cases: *The Manchester Ship Canal Co Ltd v Vauxhall Motors Ltd* [2019] UKSC 46, which was concerned with relief against forfeiture of a perpetual licence to drain into a canal for non-payment of a licence fee; and *Croydon London Borough Council v Kalonga* [2022] UKSC 7, concerned with whether there could be a forfeiture of a fixed term secure tenancy under the Housing Act 1985.

2. The two cases could not have been more different in some ways, but both cast valuable light on the nature of a forfeiture and on the availability of the remedy of relief against forfeiture. One cannot of course have relief against forfeiture if there has been no forfeiture, so it is important to know whether one is dealing with a case of forfeiture or, instead, a case of relief against an unenforceable penalty provision, or indeed with an early termination of a contract on the occasion of a serious breach. As I hope to demonstrate, we do not yet have clarity about the boundaries between these different concepts.

3. For this reason, I shall be looking later at the law on penalties, as it has recently been considered by the Supreme Court in a case called *Cavendish Square Holding BV v Makdessi* [2015] UKSC 67. There are 3 long judgments that review the whole subject, from its equitable origins, and they touch upon but do not clearly answer the interesting question of how the law against penalties relates to the law of forfeiture. On that question, there has been a good deal of confusion over the years. The concepts are quite distinct now, though they both stem from the same mediaeval origins in the Court of Chancery.

4. In the final part of my talk, I shall consider what consequences the exercise of a right of forfeiture has on the landlord's right to be compensated for the breach of covenant or contract, as compared with where a contract is terminated for repudiatory breach, or breach of a condition, or what for convenience, with apologies to Lord Diplock, I shall call 'fundamental breach'. Can a landlord, instead of electing to forfeit the lease, elect to terminate it pursuant to such a breach of contract and recover damages for loss of bargain (i.e. by reference to the rent payable for the remainder of the term of years)?

Forfeiture

5. As I have already hinted, the word "forfeit" is used in different ways in different contexts. In the context of real property law, a right of forfeiture is generally understood to be synonymous with a right of re-entry. This is a proprietary right, capable indeed of being a legal interest in land, where it is exercisable over or in respect of a legal term of years or annexed to a legal rentcharge: s.1(2)(e) Law of Property Act 1925. If exercisable over an equitable term of years, it can only be an equitable interest in land, but it is more than a contractual right. It is an interest in land because it is a

contingent right to possess the land by terminating the prior interest in possession.

6. A right of re-entry can also be created or reserved in favour of someone other than a lessor. In the classic case of *Shiloh Spinners v Harding* [1973] AC 691, a right of re-entry was reserved on an assignment of a lease, in the event that the assignee did not comply with covenants made with the assignor to fence and support the assignor's neighbouring land. The right of re-entry was valid and enforceable. The House of Lords (Lord Wilberforce giving the main speech) held that in principle relief against forfeiture could be granted, because the primary object of the proviso was to secure the result stated in the deed of assignment, which was still possible to achieve; however the House held that relief should be refused because the breach was wilful.

7. Outside the context of real property, the word "forfeiture" is used to describe a loss of rights, or even incurring a secondary liability, as a result of a breach of an obligation, and is often used synonymously with incurring a penalty. It is used in the sense of a remedy available to the innocent party and a liability of the party in breach, which is nothing to do with a proprietary right of re-entry. Thus, a licensee of a patent may have their licence terminated early (or "forfeited") for failure to account for fees or a profit share, or for excessive use of the patent. This also often occurs in the context of hire purchase or finance leases, where the equipment or other chattel is recovered by the owner upon default in payment, and the pre-payments already made are said to be "forfeited". One can see that the word "forfeit" is being used in a different way.

8. A third and more archaic sense in which the expression "forfeit" is used is the incurring of a financial liability, or the loss of money or property that was collateral for the performance of an obligation. This goes back to the

age of the defeasible bond, where a future liability was entered into by making the bond, but the bond could be redeemed on the occurrence of some specified event before the due date. If the event did not happen, the bond was said to be "forfeit", though in truth the liability under the bond was always there, but was not avoided. The word "forfeit" probably arose because the sealed bond could not, as from that time, be redeemed and recovered physically by the obligor, and so the deed itself was lost to the obligor and remained in the possession of the obligee, for enforcement.

9. You all know a famous literary example of this usage in Shakespeare's great play, *The Merchant of Venice*, which was written at a time when the equitable jurisdiction to relieve against liability under such bonds was in its infancy, relatively speaking; and it certainly did not follow from the fact that a bond was said to be "forfeit" that relief against forfeiture could be granted. If the law had been that developed in 1597, the story line of the play would have been a flop, because every judge in Venice, applying English law, would have been able to grant Antonio relief against the forfeiture of his pound of flesh. You will recall that Shylock was offered by Bassanio not just the amount of his loan in repayment of the debt but three times the outstanding money, and so the circumstances for granting relief were present, if the bond could be regarded as security for performance of the primary obligation to repay 3000 ducats. But Shylock insists on his right to have performance of the obligation in the bond.

10. The way that the words "forfeit" and "penalty" are used gives an indication that these concepts were interchangeable in English law at the time. After Balthazar (Portia in disguise) has expounded on the quality of mercy, Shylock responds: "My deeds upon my head! I crave the law, The penalty and forfeit of my bond." Balthazar declares that "This bond is forfeit" and a little later that "He shall have nothing but the penalty"; and 20 lines later "Thou shalt have nothing but the forfeiture".

11. The lack of clear distinction between a forfeiture and a penalty continued until at least 1778, when Lord Mansfield in a case of *Goodright d. Walter v Davids* (1778) Cowp 803, 805 noted that "Forfeiture is in the nature of a penalty and it has been said that the courts always lean against a forfeiture". It was at about that time that the two concepts began to diverge, first procedurally, where penalty was pleaded as a defence, and then more substantially.

12. Returning to the modern world, the decision of the Supreme Court in the *Manchester Ship Canal Co* case is important because it finally determines, at the highest level, that relief against forfeiture can be granted where the rights in question are not proprietary but only possessory. The law had probably already reached that landing point, in principle, but it remained open to challenge at the highest level of authority in relation to real property; and the proposition that relief could be granted against non-proprietary rights was challenged head-on in that case. I will come to it shortly, but there were three earlier cases of particular significance, which it is worth mentioning.

13. First, the decision of the Court of Appeal in *BICC plc v Burndy Corporation* [1985] Ch 232. In that case, P and D1 entered into an agreement to share patent rights; P was to spend money to maintain those rights and on demand D1 would reimburse it half the cost. If either party defaulted in performance of those obligations, the other was entitled to serve notice requiring the party in default to assign to the other all its rights in the patents. The judge, Falconer J, had held that the clause was not a penalty clause, and that relief against forfeiture could not be granted because of the commercial nature of the agreement. CA agreed that the clause was not a penalty, but held that relief against forfeiture could and should be granted. It held that relief could be granted in relation to

proprietary or possessory rights and was not limited to rights in land but could be granted where the rights were rights in chattels, or even incorporeal property.

14. Dillon LJ did not spend a great deal of time on the question of whether the clause was a forfeiture clause: "it is a forfeiture clause in that its enforcement would involve the forfeiture to B.I.C.C. of Burndy's half share in the relevant patent or other joint rights."

15. As far as relief against forfeiture is concerned, the key paragraph in the judgment is the following holding is as follows:

> "There is no clear authority, but for my part I find it difficult to see why the jurisdiction of equity to grant relief against forfeiture should only be available where what is liable to forfeiture is an interest in land and not an interest in personal property. Relief is only available where what is in question is forfeiture of proprietary *or possessory* rights, but I see no reason in principle for drawing a distinction as to the type of property in which the rights subsist. The fact that the right to forfeiture arises under a commercial agreement is highly relevant to the question whether relief against forfeiture should be granted, but I do not see that it can preclude the existence of the jurisdiction to grant relief, if forfeiture of proprietary or possessory rights, as opposed to merely contractual rights, is in question."

16. The decision is a landmark, though the observation about granting relief in relation to possessory rights was clearly *obiter*, as the patent rights were proprietary. And the decision left unanswered the question of what amounts to a forfeiture such as to attract the jurisdiction to grant relief.

17. Possessory rights were directly in issue in the second case, *On Demand Information plc v Michael Gerson (Finance) plc* [2003] 1 AC 368, where

relief was granted against forfeiture of rights under finance leases of video and electronic equipment. The leases were said to be "forfeited" pursuant to a contractual term, which stated that it was a repudiatory breach of the leases for the lessee to go into receivership, which it did. The terms also provided for the payment of further sums due under the leases, less the value of the equipment on the date of termination. The judge held that the termination provision was to secure the timely payment of sums due, but did not explain why it was not a termination following a repudiatory breach of contract or condition. The lessee applied for relief against forfeiture, but before that was heard the equipment was sold and the proceeds held to await the outcome of the case. The Judge held that he could not grant relief, because the equipment had been sold, so how could there be effective relief against loss of possessory rights? The Court of Appeal agreed, but held that possessory rights in relation to the equipment would have been sufficient in principle to enable the court to grant relief against forfeiture.

18. The House of Lords surmounted the procedural difficulty and held that relief could be granted using the fund as proxy for the equipment, since the purpose of the sale was to protect both parties' interests, dependent on the outcome of the issue between them. Lord Millett picked up on the judge's finding that the "forfeiture provision" was to secure payment but did not question the forfeiture further, He agreed with Robert Walker LJ in the Court of Appeal that "contractual rights which entitle the hirer to indefinite possession of chattels so long as the hire payments are duly made, and which qualify and limit the owner's general property in the chattels, cannot aptly be described as purely contractual rights. For my own part, I regard this conclusion as in accordance with principle; any other would restrict the exercise of a beneficent jurisdiction without any rational justification".

19. That reasoning is important because it recognises that relief against forfeiture cannot be granted to protect purely contractual rights, but can be

granted where the rights are possessory. It was however justified by the fact that the hirer had the right to indefinite possession of the chattels, provided that it performed the contract, so it is a particular kind of possessory right, namely exclusive, unlimited possessory rights, that the courts were addressing. The possessory rights in that case were so extensive, being close to proprietary rights (even though title formally remained with the lessor) that relief against forfeiture could properly be granted.

20. Third, in *Çukurova Finance International Limited v Alfa Telecom Turkey Ltd* [2013] UKPC 2, the Board of the Privy Council agreed with Dillon LJ's reasoning in *Burndy*. That was a case where shares were charged as security for repayment of a loan and were held in a previous decision of the Privy Council to have been validly forfeited for non-performance. The issue was whether and if so on what terms relief could be granted.

21. The Board said that "[Burndy] supports the conclusion that relief from forfeiture is available in principle where what is in question is forfeiture of proprietary or possessory rights, as opposed to merely contractual rights, regardless of the type of property concerned", and regardless of the commercial as opposed to proprietary nature of the transaction. Shares, like patents, are property rights, so again the observation about possessory rights was strictly *obiter*.

22. In *The Manchester Ship Canal Co Ltd v Vauxhall Motors Ltd* [2019] UKSC 46, the question was whether relief against forfeiture of a perpetual licence could be granted. The argument was boldly run that there could only be relief against forfeiture of proprietary interests in land, not possessory interests in land. The respondent counter-argued that not just possessory interests but any rights over land, whether possessory or not, engage the jurisdiction to grant relief against forfeiture, provided only that the termination provision can properly be regarded as security for performance.

23. The licensee failed to pay an annual fee of £50 and the canal company purported to terminate the licence pursuant to a clause that mirrored almost exactly a proviso for re-entry in a commercial lease, save that the word "determine" rather than "re-enter" was used.

24. The question of whether there had been a forfeiture and whether the termination provision was in the nature of a security for performance of the primary obligations were not live in the SC. The issues in all courts had been whether the licence created proprietary, possessory or contractual rights, and so whether relief against (assumed) forfeiture could be granted. Lord Briggs agreed with Lewison LJ in the CA that the nature of the perpetual licence was possessory, because it was very close to an exclusive right to control and use the land in question without limit of time, not just a right to pass water through the land, and so relief against forfeiture could be granted. But he emphasized that:

> "the licence granted in the present case was a very unusual one, both because it granted an element of virtually exclusive possession, coupled with a high degree of control over the locus in quo, and because it was granted in perpetuity. It by no means follows from a conclusion that the rights conferred by this licence are within equity's jurisdiction to relieve from forfeiture, that licences in relation to land will fall generally within that same boundary."

Lord Briggs referred to the *On Demand v Michael Gerson* case and noted that the lessee of the equipment had the right to enjoy the whole economic life of the chattels in question. He noted that that decision had given rise to an understanding that relief against forfeiture of chattels had to satisfy that criterion, then said at [51]:

"I would however wish to sound one note of caution against the slavish application of the whole of that jurisprudence to land. The requirement, developed in the *On Demand case [2003] 1 AC 368* and *Celestial Aviation Trading 71 Ltd v Paramount Airways Private Ltd [2011] 1 All ER (Comm) 259* that the possessory right should be one which is indefinite, rather than time limited to a period shorter than the full economic life of the chattel or other species of personal property, may have unintended consequences in relation to land. Chattels by their nature are of limited economic life, and most intellectual property rights, and patents in particular, have their own inherent time limitations. By contrast, land is a form of perpetual property, and I can well conceive of forms of possessory rights in relation to land which are not perpetual, but which might nonetheless qualify for equitable relief from forfeiture. The point need not be decided in this case since, most unusually, this licence was indeed granted in perpetuity. It is to be noted that the acknowledgment in *The Scaptrade [1983] 2 AC 694* that equity might relieve from the forfeiture of a demise charter (which is typically for much less than the economic life of the ship) suggests that even in relation to chattels a rule that the possessory right should be indefinite may go too far."

25. There is a clear hint here, in relation to possessory rights over land, that, if the SC had had to decide the point, it would have held that possessory rights over land that amounted to a virtually exclusive right to possess for a more limited period of time would have been treated in the same way as the perpetual licence – indeed, it is hard to see how there could be a difference in principle if the licence in Manchester Ship Canal was for 80 years rather than in perpetuity, or indeed for 20 years or 5 years, since the degree of exclusive possession was the same and the right of forfeiture was security for payment of the annual fee.

26. The Court dealt swiftly and adversely with the argument that any right over land could be the subject of relief against forfeiture. It stuck to the line that relief could only be granted in respect of proprietary or possessory rights. So, e.g., an easement, a right of way across land appurtenant to the owner's land for a term of years at a rent could, it seems, attract relief against forfeiture, being a proprietary right, but a licence to use the same right of way would not, because it is not possessory.

27. So we are left as a result of that decision with a slightly unsatisfactory position that, as a matter of the law of relief against forfeiture, in principle there is no distinction to be made between proprietary and possessory interests, or between land and chattels, but there may well be a distinction between the extent of the possessory interest needed in chattels, as compared with land, for relief to be capable of being granted. Whether there is such a distinction or not, and if so what it is, has not been authoritatively decided. Furthermore, there is no clarity about what amounts to forfeiture in relation to possessory interests in land or chattels, as distinct from a contractual termination. On the facts of *Manchester Ship Canal* this was not an issue, because there clearly was in substance a proviso for re-entry. Lord Briggs reminds us in *Manchester Ship Canal* that for relief to be granted the forfeiture provision needs to be conferred by way of security, but that potentially leaves open two further categories: where the forfeiture is not in the nature of a security; and where there is no forfeiture but only a contractual termination. What therefore is a forfeiture?

28. In the context of leases of land, the answer to the question "what is a forfeiture" is now clear, in that Lord Briggs, in *Croydon London Borough Council v Kalonga* [2022] UKSC 7, approved two Court of Aappeal decisions, *Clays Lane Housing v Patrick* (1984) 17 HLR 188 and *Richard Clarke & Co v Widnall* [1976] 1 WLR 845. In the *Clays Lane* case, Fox LJ had said at p.193:

"We accept, for present purposes, the submission on behalf of the co-operative that a right to determine a lease by a landlord is a right of forfeiture if (a) when exercised, it operates to bring the lease to an end earlier than it would 'naturally' terminate; and (b) it is exercisable in the event of some default by the tenant."

Lord Briggs said that that was a "good working definition" of what in substance constitutes a provision for forfeiture in a tenancy agreement, both under the general law and under statute.

29. The *Kalonga* case was unusual because it involved a fixed term secure tenancy (not the norm) which stated that the landlord could bring the tenancy to an end early on any of the grounds in Sch 2 to the Housing Act 1985 (the well known mandatory and discretionary grounds, including arrears of rent, anti-social behaviour, suitable alternative accommodation, and so on). After 2 years of a 5 year term, the Council served a notice seeking possession on grounds of rent arrears and anti-social behaviour (the standard statutory notice giving notice of intention to start proceedings for possession). The claim for possession did not rely on forfeiture but only on the service of the notice and the statutory grounds. There was a preliminary issue on how a landlord under a fixed term tenancy could and should terminate the tenancy. The tenant argued that there had to be a forfeiture and that the council did not claim a forfeiture, therefore the claim failed. The Judge decided that there was no forfeiture provision in the standard terms of the tenancy and no other provision for early termination either, and so dismissed the claim. The CA agreed the result, but said that the only way to obtain an order for possession in lieu of forfeiture, pursuant to s.82(3) of the 1985 Act, was to take the essential preliminaries to forfeiture under s.146 of the LPA 1925, giving the tenant the opportunity to claim relief.

30. Although the issues were academic for Ms Kalonga's tenancy by the time of the appeal, the Supreme Court considered that they were important and needed to be decided. The issues were (a) whether obtaining an order for termination in lieu of forfeiture was the only way of terminating a fixed term tenancy, and (b) whether the standard form tenancy agreement contained a forfeiture provision. It is the second with which I am concerned because it addresses the question: when is there a forfeiture under contractual provisions for termination?

31. Lord Briggs said at [50]:

"Whether a particular clause is or is not a forfeiture clause is a question of substance, not form. This is because the classification of a termination clause as a forfeiture attracts what was originally the equitable remedy of relief from forfeiture. In the landlord and tenant context that remedy is now statutory (apart from forfeitures based on non-payment of rent), but its raison d'être remains the same", and at [51]:
"It is not open to the drafter to avoid the consequences of a provision being in substance a forfeiture (and thereby attracting the jurisdiction to grant relief) by dressing it up as something else in form."

32. These were the relevant terms of the tenancy:
"Following the review we will take action to end your tenancy and repossess the property if:

> 'you have not kept to any of the conditions of the tenancy; …'
> 'We may also take eviction action at any time [my underlining] if one or more of the grounds for possession set out in Schedule 2 of these conditions apply …'; and

"We may seek possession if … you break any of the clauses of this agreement, or if any of the grounds in Schedule 2 of the Housing Act

1985 as amended by the Housing Act 1996 , or for any other ground that is made law and applies in the future, are breached".

33. The Supreme Court held that although these were not expressed as forfeiture provisions, in substance they were, to the extent that they related to seeking possession early on grounds that amounted to breaches of obligation. That fitted the good working definition of forfeiture, because their effect was to bring the tenancy to an end early on grounds of default by the tenant. So, they being forfeiture provisions in substance but not form, s.82(3) applied, and the tenant was entitled to seek relief against forfeiture within proceedings started under s.82(3). Lord Briggs said that proceedings to seek termination in lieu of forfeiture "would have required Croydon to have complied with the statutory and common law requirements for forfeiture, so as in particular to enable her to seek relief".

34. That is all clear and, with respect, sensible in the context of an estate in land. But is the good working definition of a forfeiture provision in a lease a good working definition of a forfeiture of other proprietary rights, such as shares or patents, and of possessory rights in land or chattels? I think that it may well be a good starting point, but not a complete answer.

35. Shares are not usually owned for a term of years but in perpetuity, and a provision that brings that ownership to a premature end as a result of breach of an obligation owed by the holder, looks very much like a forfeiture of property. The fact that the property in dispute may have a limited life-span, as in the case of patents, does not prevent the ownership being terminated prematurely on account of a breach of obligation. And for possessory as opposed to proprietary rights, a contractual provision that terminates the possessory rights early on account of a breach of an obligation of the possessor, also looks like a forfeiture of the rights over the land or chattel in question.

36. However, termination under the general law, such as for repudiatory breach of contract, is not forfeiture. In the first place, it is a right that exists independently of the written terms of the contract, though in more sophisticated contracts, with detailed termination provisions, it is sometimes expressly spelled out. Forfeiture and termination for breach are not synonymous. So, does it necessarily become a forfeiture if the contract confers possessory rights, or if there is an express term providing for early termination on breach, or if both factors are present? I cannot see how reliance on the general law to terminate a contract for repudiatory or fundamental breach amounts to a forfeiture, even if possessory rights under the contract are thereby brought to a premature end. And why should it make a difference if the terms of the contract simply replicate the right under the general law to terminate early by notice in the event of a repudiatory breach? Is a forfeiture, perhaps, a provision for early termination in the event of breach that would not otherwise entitle the innocent party to terminate the contract that makes such a clause a forfeiture clause?

Penalties

37. These questions are unanswered and I will leave them floating in the air while I deal with penalties, and come back to them later.

38. The old test for a penalty was, broadly, whether it was a genuine pre-estimate of loss that could be expected to flow from the contemplated breach of contract, or whether it was a stipulation *in terrorem* the obligor. The indicia of penalty or not were explained in in *Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd* [1915] AC 79 by Lord Dunedin, which as was said in the *Cavendish Square Holding BV v El Makdessi* case to which I will shortly come, assumed the status of a quasi-statutory code.

The rules that Lord Dunedin held were material, where they applied, were (in summary):

(a) that the provision would be penal 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"; (b) that the provision would be penal if the breach consisted only in the non-payment of money and it provided for the payment of a larger sum; (c) that there was "a presumption (but no more)" that it would be penal if it was payable in a number of events of varying gravity; and (d) that it would not be treated as penal by reason only of the impossibility of precisely pre-estimating the true loss

39. Subsequent case law unearthed all kinds of difficulty in applying those rules to cases which they did not really fit, but the "genuine pre-estimate of loss", rather than "extravagant and unconscionable amount" likely to have been specified in terrorem, was the test generally applied. Greater difficulty arose where the putative penalty was not the payment of money but the inability to recover money already paid or the loss of a right to be paid or to the transfer of property.

40.

41. The facts of the *Cavendish Square Holding BV v El Makdessi* case, grossly simplified, were that M agreed to sell a majority shareholding in an advertising and marketing company that he had founded, for up to $147m. The consideration was payable in stages, over years, and its exact amount depended on a deferred profits analysis. A substantial amount of the consideration reflected the goodwill of the business, and, to protect that, M covenanted not to compete with the business for a specified period. He agreed that if he did compete (a) he would not be entitled to any further payment of the price, and (b) Cavendish Square would be entitled to buy his remaining shares at a price that excluded goodwill. You can guess what happened, and CS sought declarations that it was entitled to enforce those

contractual provisions. The Judge held that they were not penalties but the Court of Appeal held that they were, on the basis that the clauses were not genuine pre-estimates of loss but rather their function was to deter non-compliance.

42. There were 3 different substantial judgments in the Supreme Court: a joint judgment of Lords Neuberger and Sumption, a judgment of Lord Mance, and a judgment of Lord Hodge. All agreed that the appeal should be allowed on the basis that, although the provisions were for secondary obligations in the event of breach of a primary obligation, and therefore potentially a penalty, they were not penal in nature because (very broadly) they reflected the importance of the legitimate commercial interest that Cavendish had in performance by Makdessi. The true test was encapsulated most crisply by Lord Hodge:

"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. Where the test is to be applied to a clause fixing the level of damages to be paid on breach, an extravagant disproportion between the stipulated sum and the highest level of damages that could possibly arise from the breach would amount to a penalty and thus be unenforceable. In other circumstances the contractual provision that applies on breach is measured against the interest of the innocent party which is protected by the contract and the court asks whether the remedy is exorbitant or unconscionable"

43. All three explored the origins of the penalty law, in England and Wales and in Scotland. Lords Neuberger and Sumption explained that the common origin of the principles of unenforceable penalty and relief against forfeiture diverged in the 18th Century, when the courts of common law devised their

own procedural remedy to protect the obligor, involving a requirement for the plaintiff to plead their loss, and there followed a stay of the action on the bond upon payment into court of the loss, interest and costs. Although this started out as an exceptional requirement, it became the standard order made. Equity, on the other hand, proceeded by granting relief when the penalty could be recognised as being security for performance of the primary obligation. So the common law proceeded by holding the penalty to be contrary to public policy and unenforceable beyond the amount of actual loss; but in equity there is nothing contrary to public purpose about the right to re-enter or foreclose; relief is granted if the primary purpose of the parties' bargain can be achieved by substituted (usually meaning late) performance.

44. Then we come to the interesting part (for my purposes). The penalty jurisdiction only arises where there is a breach of contract. It only regulates remedies for breach of contract, not a variation in the extent of the primary obligation. So there is some similarity to the good working definition of forfeiture in that respect: the remedy has to arise upon a breach of contract. There must be a breach of a primary obligation. If there is no breach but merely an agreement that <u>if</u> something is not done, or if something occurs, a payment will be made, that is not a penalty.

45. And then this, at [17], per Lords Neuberger and Sumption:

"The relationship between penalty clauses and forfeiture clauses is not entirely easy. Given that they had the same origin in equity, but that the law on penalties was then developed through common law while the law on forfeitures was not, this is unsurprising. Some things appear to be clear. 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."

46. That appears to be holding that a contractual provision for termination of a proprietary or possessory interest on breach is a forfeiture provision and cannot be a penalty or other termination provision (presumably because it is regarded as security for performance of the principal obligation). However, in the very next paragraph, the Justices said:

"What is less clear is whether a provision is capable of being both a penalty clause and a forfeiture clause. It is inappropriate to consider that issue in any detail in this judgment, as we have heard very little argument on forfeitures—unsurprisingly because in neither appeal has it been alleged that any provision in issue is a forfeiture from which relief could be granted. But it is right to mention the possibility that, in some circumstances, a provision could, at least potentially, be a penalty clause as well as a forfeiture clause. We see the force of the arguments to that effect advanced by Lord Mance and Lord Hodge JJSC in their judgments." That appears to be something of an afterthought, and it is inconsistent with the apparently clear conclusion in the previous paragraph.

47. Having reviewed a number of authorities in which the availability of relief under the law of penalties overlapped to some degree with questions of relief against forfeiture, Lord Mance said at [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 performance…. 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."

48. But in that paragraph, Lord Mance has himself explained there why a true forfeiture provision cannot be a penalty. It would not be penal if it is regarded in equity as a security to enforce performance of the original bargain. It cannot be said that a forfeiture provision is penal in the event that relief against forfeiture is not granted, otherwise every proviso for re-entry in the event of non-payment of ground rent in a long lease would be a penalty and unenforceable. A forfeiture provision that equity regards as a security for performance and treats as such cannot be unenforceable as a penalty provision. As Dillon LJ said in relation to the provision requiring transfer of the 50% share of patent rights in *BICC v Burndy*:

"[it is] no more a penalty clause than is the ordinary power of re-entry in a lease or the ordinary provision in a patent licence to enable the patentee to determine the licence, however valuable, in the event of non-payment of royalties"

49. It is therefore unclear what category of forfeiture provision Lord Mance had in mind, and this might be why Lords Neuberger and Sumption referred to a provision *potentially* being both - as a true forfeiture provision, which secures performance of the bargain, could not be a penalty. But for the same reason, something that might more loosely be called a forfeiture provision, such as a right to terminate for breach a non-exclusive licence to use land, or limited rights to use chattels that were not possessory, could be a penalty because it could not attract relief against forfeiture.

50. Lord Hodge went further than Lord Mance, in saying that he saw no confusion of principle in a single clause being capable of being both a penalty and a forfeiture. This was said in the context of forfeiture of sums of money that were otherwise due to the party in breach, as was the case with the outstanding purchase price instalments in *Makdessi*. Lord Hodge agreed with the other justices that there can be no distinction between a secondary obligation to pay money on breach and a forfeiture of their right to be paid money otherwise due. At [227] he said:

"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".

51. That is, of course, addressing a "forfeiture" in a very different sense from the forfeiture of proprietary or possessory rights. As Lord Hodge said, an entitlement on the part of the innocent party to withhold a sum of money otherwise payable is no different in principle from a liability on the part of the party in breach to pay the same amount to the innocent party. The only relevant question is whether it is a penalty. If it is not, there is no question of relief against forfeiture being granted against the lawful withholding of a

sum of money. Conversely, in *BICC v Burndy*, on which Lord Hodge relied for his suggested approach, there was no question of the proviso for assignment of the patent rights being a penalty: the only question was whether it was a type of forfeiture against which equity could grant relief.

52. I suggest therefore that the notion that a single clause in a contract might be arguably unenforceable as a penalty and a forfeiture giving rise to relief against forfeiture is more theoretical than real. The first question needs to be: is this a forfeiture against which relief can in principle be granted? If so, it cannot be a penalty.

Damages

53. Finally, I return to the question of how a true forfeiture provision is to be distinguished from a right to terminate a contract for breach. Are these two concepts mutually exclusive? If we have a true forfeiture provision, such as may give rise to an equitable (or statutory) jurisdiction to relieve against forfeiture, does that exclude the ability of the obligee to terminate the contract for repudiatory or fundamental breach, i.e. under the operation of the general law of contract?

54. Why does that matter? It matters for two reasons. First, there is no relief that can be granted against a valid termination of a contract where the innocent party accepts a fundamental or repudiatory breach of contract, or breach of a condition (except in the usual cases of mistake and fraud). The contract is terminated, a duty to mitigate arises, and damages follow. Second, if there is a termination for repudiatory breach, or breach of condition, the obligee is entitled to sue for damages as well as terminate the contract, and damages may be recovered on a loss of bargain basis. But that has never been recovered upon a forfeiture of land.

55. Let me give an example. A bank leases an office block. The rent is very high indeed. The lease is for 25 years. The lease contains the usual proviso for re-entry. The bank becomes insolvent. Its administrators courteously explain to the landlord that they will be unable to pay any more rent after the next quarter day and they will vacate the building and hand over the keys. The landlord retakes possession, only to secure the building and ensure that the plant is safely decommissioned, and then sues the administrators for millions of pounds for the rent that would be paid over the residue of the term of the lease, discounted for accelerated receipt and allowing for mitigation of loss by trying to re-let second hand space in a poor market.

56. Does the landlord have a claim for loss of bargain?

57. These are a simplified version of the facts in what would have been the great case between Canary Wharf and Lehman Brothers. It was a great case for me and my opponent, but sadly not in any one else's consciousness, because it settled a day or so before an 8-week trial was due to start.

58. There was a key factual issue about whether the landlord had in fact sought to forfeit or accept a repudiatory breach of contract, and an important legal issue about whether a legal estate in land can be terminated by repudiatory breach. It was reasonably clear that there was a repudiatory breach, assuming that the lease could be terminated in that way – the administrators said that they would pay no more rent and handed the block back, but it appeared that the landlord had re-entered rather than accepted a repudiatory breach. The landlord argued that if it did forfeit, by doing so it was also terminating the lease by way of acceptance of the repudiatory breach. If that was wrong and there was only a forfeiture, did the law nevertheless allow

damages for loss of bargain to be claimed? All of these interesting questions would have been answered by Rose J, had the case gone ahead.

59. It has always been understood that a landlord who forfeits a lease cannot claim damages for loss of bargain, even if the breach of the lease is a serious or repudiatory breach. But why?

60. I think the probable answer is that in such a case, if the landlord forfeits, it is electing to exercise a proprietary remedy, pursuant to the legal or equitable right of re-entry annexed to the reversion, not a contractual remedy. The two remedies have different consequences – and are to that extent inconsistent – and so a landlord must elect between them. If the landlord re-enters, it is entitled to damages caused by the breach up to the date of re-entry and only mesne profits thereafter, if it is denied possession of the land. That is what has traditionally been understood and regularly claimed in forfeiture cases, but admittedly there is no clear authority saying why damages for loss of bargain are unavailable.

61. But what is there to prevent a landlord from electing to accept a repudiatory breach of the lease instead? After *National Carriers v Panalpina*, deciding that there can in principle be frustration of a lease, it is difficult to sustain the argument that there cannot be repudiatory breach of a lease, at least as between the original parties – once there has been an assignment of the lease or the reversion, the liability is governed by statute now, and by privity of estate under the pre-1995 regime. But if there can be a repudiatory breach, why could the landlord not say "I accept your repudiatory breach and our contract of lease is at an end". That would have the effect of excluding the grant of relief against forfeiture, and enabling the landlord to seek loss of bargain damages.

62. And even more so if the rights are nothing to do with real property or are possessory only – e.g. a finance lease of computer equipment. The lessor then relies on a contractual termination provision or the general law of contract, not a proprietary right of re-entry. According to Lord Briggs's good working definition, that is a forfeiture if it terminates the possession of the equipment early on account of a breach of contract by the hirer. But there is no right of re-entry: only the contractual rights that the lessor has. If in fact the breach of contract relied upon was repudiatory, can the lessor recover damages for loss of bargain (assuming relief against forfeiture is not granted)? If not, can the lessor make clear that it is accepting a repudiatory breach of contract under the general law and not forfeiting, so as to preserve its entitlement? Or is it in law nevertheless a forfeiture?

63. My own tentative view, reached of course without the benefit of adversarial argument, is that where a proprietary right of re-entry is not in play, if there is a fundamental or repudiatory breach of contract and the innocent party terminates the contract relying on the general law. That is consistent with the principle that one can retrospectively justify a termination of a contract on the basis of a repudiatory breach of which one was unaware at the time of purported termination – i.e. it took effect as a valid termination even though the breach was unknown. But where the termination is pursuant to a term of the contract that permits early termination that would not be available under the general law, it is a forfeiture, if its effect is in accordance with Lord Briggs's good working definition. And if proprietary or possessory rights are involved, there is jurisdiction to grant relief against forfeiture. So Lord Briggs's good working definition works well in the context of real property, but there is some further analysis needed where it is chattels or possessory rights that are terminated.

64. These tricky questions do illustrate the real importance of clarity about the nature of forfeiture as a remedy; whether the principles applicable in the

case of forfeiture are the same if one is concerned with a proprietary interest in land, a possessory interest in land, or a proprietary or possessory interest in a chattel; and how these principles relate to the general law of contract, including the right to claim damages for loss of bargain and the law of penalties.

65. One day, there will be another Canary Wharf v Lehman case, and I hope that I am still around to judge it.