HOLYOAKE V CANDY [2017]: HOW TO AVOID FALLING FOUL OF THE PENALTY DOCTRINE

The recent decision of the High Court in *Holyoake v Candy*[1] has reinforced the doctrine that penalties only apply to clauses that are triggered on a breach of contract.

Introduction

In 2015, the Supreme Court re-wrote the law on penalty clauses in its judgments in *Cavendish Square Holding BV v Talal El Makdessi*; and *ParkingEye Limited v Beavis*[2 3]. In *Holyoake v Candy* the High Court has applied these principles to provisions in a loan agreement and various supplemental agreements. The judgment illustrates that, through the use of careful drafting, you can avoid the doctrine of penalties by framing the payment as a primary obligation.

1. [2017] EWHC 3397 (Ch)
2. [2015] UKSC 67
3. http://www.hfw.com/downloads/HFW-Dispute-Resolution-December-2015.pdf

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What has happened?

In 2011, a company, of which Holyoake was the ultimate beneficial owner, purchased a London property for development for £42m. Facing a tight deadline for completion, Holyoake negotiated a loan of £12m which was made to him personally from CPC Group Limited, a company owned by Christian Candy.

Having failed to develop the property, Holyoake sold the property in 2014 for £86m. However, Holyoake was required to repay CPC over £37m. This sum included the loan, interest, a minimum profit share and fees for extending the repayment term of the loan. After paying other costs associated with the property, the project ultimately made a substantial loss.

The key points on penalties

Holyoake brought a number of claims, including claims for fraudulent misrepresentation and duress. Of particular interest is the way in which the judge, Nugee J, categorised certain provisions of the agreements that Holyoake claimed were penalties.

Nugee J summarised the relevant principles of the English law doctrine of penalties, as developed in *Cavendish Square Holding BV v Talal El Makdessi*; and *ParkingEye Limited v Beavis*:

1. The doctrine applies only to contractual provisions operating on a breach of contract. The rule applies to breaches of the primary obligations under an agreement, not to the primary obligations themselves.
2. The question of whether the doctrine applies to a contractual provision depends on the substance of the provision and not its form. However, because the doctrine applies only to breaches of primary obligations, the application of the rule may depend on how the relevant obligation is framed and can turn on how the provision is drafted.
3. Where the doctrine applies, the test for whether the provision is a penalty is whether a legitimate business interest is served and protected by the clause (and if so what that interest is). If a legitimate interest is served, then the Court must consider whether the relevant provision made for the interest is “*nevertheless in the circumstances extravagant, exorbitant or unconscionable*”.

The judgment of Nugee J illustrates the application of each of these principals, finding that none of the clauses amounted to penalties:

1. The loan agreement between Holyoake and Candy provided for early repayment of the loan, upon which Holyoake also had to repay all the interest that would have accrued by the end of the term of the loan. Nugee J stated that this was not a provision expressed to operate on a breach, but instead the clause created a primary obligation. In effect, when Holyoake borrowed £12m, he was agreeing to repay £17.74m.
2. Holyoake missed a deadline to refinance, and so the parties entered into an extension agreement, under which Holyoake would pay an extension fee in return for being allowed to re-pay the outstanding balance in monthly instalments. If the extension fee was paid on time then it would be credited against the principal amount of the debt. Nugee J stated that this clause had the same effect as a provision that Holyoake should make interim payments in respect of the debt, with provision for the payments to be added to the debt if not paid in time.

   However, the deciding factor was that the fee was framed as a primary obligation, expressly payable in return for an extension of time. In general, parties are free to decide what sums payable under a contract are payable for.

3. A later extension agreements did engage the penalty doctrine, as Holyoake would not have been charged further interest if he had adhered to the specific repayment structure. Holyoake claimed that charging double interest, not the specific rate of interest, was penal.

   Nugee J held that it was not penal to stipulate for further interest to be paid in the event that the balance became due because, once the debtor is in default, the creditor is being kept out of its money and running an enhanced credit risk.

HFW perspective

The Court in *Cavendish Square Holding BV v Talal El Makdessi;* and *ParkingEye Limited v Beavis* recognised that in some cases the application of the penalties doctrine can turn on questions of drafting, particularly how the relevant obligation is framed. In the Holyoke v Candy judgment, Nugee J gave further useful guidance on how this can be done.

To avoid falling foul of the penalty doctrine:

1. Frame the provision as a primary obligation and ensure that the interest provision is not expressed such that it operates only on a breach.
2. Any interest payment should be in return for a specific benefit given to the other party, such as an extension of time or an increase in the amount of the loan.
3. If the provision does only operate on a breach, ensure that the type of penalty can be justified based on actual losses.

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