The Scope of the Rule against Contractual Penalties: A New Divergence

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Contractual clauses that purport to impose a penalty are unenforceable at common law. At least in England and Wales, it is established that this rule applies only where the event triggering the alleged penalty is a breach of contract or an event that cannot occur without breach. Australian law was widely understood to be the same until the High Court of Australia, in Andrews v ANZ [2012] HCA 30, held that equity may provide relief against a contractual penalty even where the event triggering the alleged penalty can occur without a breach of contract. Instead of regarding this decision as an Australian divergence from a traditional rule and justifying it by reference to specific Australian conditions, the High Court of Australia regarded its decision as doing no more than maintaining (or reinstating) the law as it had stood in the 19th century in England, the United States and, by implication, Australia. In the High Court’s view, therefore, it is the restriction of relief to cases of breach, rather than the availability of relief in cases not involving breach, that constitutes a divergence from orthodox principles.

The paper will investigate the circumstances in which Australian courts can now grant relief against contractual penalties. It will also discuss whether courts in other common law countries ought to follow the decision by the High Court of Australia or whether that court ought to reconsider its decision.