A2/2005/0836

Neutral Citation Number: [2006] EWCA Civ 408
IN THE SUPREME COURT OF JUDICATURE
IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE HIGH COURT
THE QUEEN'S BENCH DIVISION
(MASTER EYRE)

Royal Courts of Justice
Strand
London, WC2

Tuesday, 14th March 2006

B E F O R E:

LORD JUSTICE MUMMERY
LORD JUSTICE DYSON
SIR CHARLES MANTELL

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CMC GROUP PLC & ORS

CLAIMANT/RESPONDENT

- v -

MICHAEL ZHANG

DEFENDANT/APPELLANT

- - - - - - -

(DAR Transcript of
Smith Bernal Wordwave Limited
190 Fleet Street, London EC4A 2AG
Tel No: 020 7404 1400 Fax No: 020 7831 8838
Official Shorthand Writers to the Court)

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MR S HOSSAIN (instructed by the Bar Pro Bono Unit) appeared on behalf of the Appellant

MR M WESTGATE (instructed by Messrs Bryan Cave of LONDON EC4M 5TE) appeared on behalf of the Respondent

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J U D G M E N T

1. SIR CHARLES MANTELL: I should wish to begin by saying that I am very grateful to both counsel for the arguments which they have presented in this not entirely easy case, and in particular to Mr Hossain, who appears acting pro bono and who has performed valiantly in presenting this application or, as it will become, this appeal. Mr Westgate likewise has presented his arguments cogently and with great economy.

2. The applicant, Michael Zhang, is a Canadian citizen of Chinese extraction. His first language is not English. He is interested in the financial markets and to that end he got in touch with the respondents, CMC Group, with a view to carrying on business as a real time internet trader. He wanted to place monies with them for foreign exchange transactions. In fact, he did just that. Substantial sums of money were placed and it appears that at one stage something may have gone wrong with the respondents' system, because whereas it was Mr Zhang's intention to carry out only two transactions, three in fact were carried out, or so he has claimed.

3. Since one of those two that he intended to carry out was a losing transaction, the result of it being duplicated was to increase his losses, and that was a source of grievance to him and the subject of a complaint which he made to the respondents. He came to London to pursue that complaint, and there he had contact with the respondents, who in due course reached what they considered to be an agreement which would have the result of forestalling any legal action which Mr Zhang might otherwise have been disposed to bring. The agreement, committed to writing on 7 August 2003, framed as it appears from the heading by solicitors, was a without prejudice offer. It is necessary to read the whole of that letter to understand its effect. It is addressed to Mr Zhang:

> "Dear Sir - We write to confirm that CMC Group Plc ("CMC") are willing to offer the sum of US$40,000 in full and final settlement of all past present or future claims howsoever arising out of or in connection with the subject matter of your complaint [the matter which has been mentioned already in the course of this judgment]. This is on the following basis: 1. The terms of this settlement being strictly confidential. 2. You will cease from harassing and making any threats of violence to any officer, employee of CMC and/or their families. 3. You will not make any form of derogatory or unfavourable communication about or in connection with CMC by any means (in person, in writing or orally – to include both electronic and non-electronic means i.e. fax, Internet, etc) whether through yourself, your family members, agents or servants. This offer is put forward entirely without admission of liability, and is simply a commercial offer proposed to finalise the relationship between you and CMC. For the avoidance of doubt, you hereby agree that any breach of this settlement and agreement will render you liable to us for the sum of US$40,000 together with a claim for reimbursement of our legal costs against you in addition to a claim for damages in relation to loss of business. Such a claim could be considerable. This offer remains open for acceptance until 4pm today, 7 August 2003."

4. That agreement appears – and it is not suggested that it is not – to be signed by Michael Zhang, by which no doubt he was acknowledging himself bound by its terms. It

was to be his allegation, made later, that he was obliged to sign that agreement under duress. Indeed Mr Zhang, who most unfortunately has health problems of a certain kind, has felt that he was being harassed and indeed improperly dealt with by employees of the respondents. Notwithstanding the agreement, he continued to make demands against the respondents claiming money which he said was owed to him far in excess of US$40,000. It appears, or it was so alleged, that he went to the respondents' premises and got in touch with its members of staff by various means and made, so again it was alleged against him, a thorough nuisance of himself.

5. So it was on 25 May 2004 that the respondents, CMC, began an action against him. The claim form, which is to be found in the bundle at tab 1, claimed under the terms of the agreement the US$40,000, wrongly expressed as pounds, which it was said by the terms of the agreement would be payable on breach of the agreement. It also asked for an injunction to prevent Mr Zhang from harassing or communicating with members of their staff or coming to their premises, and further there was a claim for damages. In the period that followed, the respondents obtained an interim or several interim injunctions which, as we have been told, led to Mr Zhang coming before a number of judges of the Queen's Bench Division, and being committed for contempt of court. As it happened, Mr Zhang himself started an action against the respondents in which he claimed sums of money which far exceeded the US$40,000, which by this time he had received, and also damages for harm which had been done to him, so he was to say, by servants or agents of the respondent, including a most serious allegation that he had been poisoned on an occasion when he had eaten a chicken wing in a restaurant leading to him suffering, as no doubt he did suffer, a very serious skin complaint which rendered him unable to follow any kind of gainful employment for a considerable period of time.

6. However Mr Zhang did not file an acknowledgment of service to the respondents' claim. The respondents applied to have judgment entered in default, and such was to happen on 5 November 2004, when the Master entered judgment on behalf of the respondents and ordered that the defendant pay the claimant an amount and costs "which the court will decide". That was in effect an order for damages to be assessed. The matter came before Master Eyre on 5 April 2005 for assessment to be made. On that occasion the Master gave judgment for the respondents, claimants in the action of course, in the sum of US$40,000 and he also awarded £1,000 in damages. That related to allegations in the claim that there had been harassment of the respondents' employees. Further, Mr Zhang was ordered to pay the costs of the action, to be the subject of a detailed assessment on the standard basis, with £10,000 payable on account. The application for injunctions contained in the claim form were referred to a judge. At the same time, the Master struck out Mr Zhang's claim against the respondent. He took the view that it was an attack on the judgment which the respondents themselves had recovered and that in itself was impermissible, or further that it was barred by reason of the compromise agreement, the terms of which I have already recited.

7. Now, Mr Zhang was not at all happy with the outcome of that hearing. He wished to appeal. In the first instance the matter came before Waller LJ. That was on 22 June 2005. The documents before Waller LJ seemed to have been incomplete and the

picture which they presented was, it is perhaps fair to say, somewhat confusing. But there was enough in the material to cause Waller LJ some concern, and in the course of a short judgment he identified what those matters were. First of all, he was concerned whether the respondents' claim had been properly served within the jurisdiction. That as a concern has disappeared because it appears from the documents that it had. He was also concerned that the claim form referred to £40,000 rather than dollars, but that is, as has been discovered, again to be something of no consequence. He was – and this is what gives rise to the present application – also anxious whether or not in the terms of the agreement which I have read out, the US$40,000 recovered was in the nature of a penalty. That is a matter to which I must return.

8. Waller LJ was also concerned that costs had been paid without a bill having been presented, and also as to the order for damages. As I have said, the only matter arising out of that – the Lord Justice having ordered that the matter continue as an application with the appeal to follow, which is the reason it comes before this court today – is the question of the so-called penalty. As it happens, Mr Zhang's application for leave to appeal against the striking out of his own action came before Dobbs J shortly after the matter had been heard by Waller LJ; and although it is not entirely clear whether Dobbs J had sight of the judgment of Waller LJ, it is clear that she refused Mr Zhang leave to appeal in relation to the striking out of his action.

9. So this court is now concerned with whether the provision in the letter of 7 August 2003 is to be regarded as a penalty clause. That is to say, the provision which made Mr Zhang liable to pay the sum of US$40,000 in the event of there being a breach of the agreement. It is perfectly true to say that that matter was not raised before the Master. Two preliminary points are taken, although not necessarily at the forefront of the argument presented on behalf of the respondent. The first is that the judgment in default itself disposed of the point about the penalty because it was a judgment on liability. But I have read out the terms of that order, which was to refer all matters of damages and costs to the court of assessment, such being matters which, I quote again, "the court will decide". In my view the judgment on liability did not dispose of quantification, which fell to be decided, should it be raised, before the Master on the hearing of the assessment.

10. The second preliminary point which is raised is that the point was raised before the Master. It would be a sad thing, in my view, if a litigant in person is to be prevented from raising on appeal something which he had not been able, through lack of experience or knowledge, to present on his own behalf at the first hearing so as to prevent the matter from being decided at all. Of course, one way of dealing with it would be to remit the question to the Master for his decision. But Mr Westgate for the respondent does not invite us to do that, no doubt having a shrewd eye on costs. For my part, at any rate, I am prepared to hear the argument on penalty, notwithstanding it was never put forward before the Master.

11. I turn, then, to the central question. By the agreement of 7 August 2003, put at its crudest, CMC was buying protection against litigation and against the harassment of its staff. The sum mentioned of US$40,000 was no doubt offered and accepted on the basis

of the parties' estimate of the actual, or even nuisance, value of any claim which might be brought by Mr Zhang. But even after the alleged breach of the agreement by Mr Zhang, by the terms of the agreement and indeed as proved by events, CMC retained the benefit of the shield against legal action. Indeed, it was deployed in the defence offered against Mr Zhang's claim in negligence and for breach of contract. The figure of US$40,000 had no direct relevance to the harassment claims save that it might serve – so I would say on a plain reading of the letter of 7 August – as a threat, and I do not use that term perjoratively. In no way could it be said, so it would appear to me, to have been an attempt to evaluate any loss or damage sustained as a result of the breach which was alleged against Mr Zhang, namely his continuant harassment of the staff of CMC.

12. Without reference to authority, and just on a reading of the letter, it would appear to my eyes that the provision for the payment of US$40,000 was a penalty. It had been introduced as a deterrent to Mr Zhang and as an inducement not to break any of the terms of that agreement, which it is quite unnecessary for me to read again. But we have been referred to authority. It is perhaps necessary only to refer to one or two of the cases mentioned. The first and best known is Dunlop Pneumatic Tyre Co Limited v New Garage and Motor Co Limited [1915] AC 79, and in particular a passage in the speech of Lord Dunedin which begins at page 86 and continues onto page 87. It sets out very clearly, albeit in slightly antique language, what a penalty clause is. At page 86, Lord Dunedin said this:

> "The essence of a penalty is a payment of monies stipulated as in terrorem of the offending party and the essence of liquidated damages is a genuine covenanted pre-estimate of damage. 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."

13. And then in two paragraphs, perhaps pertinent to the present question before the court, at 4(a) on page 87:

> "It 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."

14. And at (c) on the same page:

> "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'."

15. Both those paragraphs would seem to me to apply to the letter and the agreement in question. For the sake of completeness, and having perhaps appeared to criticise the speech of Lord Dunedin for the slightly dated language which it employed, it is perhaps right to refer to Murray v Leisureplay [2005] EWCA Civ 963, where Arden J in the

course of her judgment cited with approval a recasting of Lord Dunedin's test as put forward by Colman J in Lordsvale Finance plc v Bank of Zambia [1996] QB 752 at 762(G). I quote from the judgment of Colman J:

> "Whether a provision is to be treated as a penalty as a matter of construction to be resolved by asking whether at the time that 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 breach. That the contractual function is deterrent rather than compensatory can be deduced by comparing the amount that would be payable on breach with the loss that might be sustained if breach occurred."

16. Now, Mr Hossain on behalf of Mr Zhang says, looking again at the letter of 7 August 2003, is it not true that the breaches contemplated, particularly in sub-paragraph (3) of the conditions, are certainly capable of incurring very modest damages, for example "You will not make any form of derogatory or unfavourable communication about or in connection with CMC by any means". That could, as my Lord, Mummery LJ observed in argument, perhaps include a letter sent by a solicitor acting on behalf of Mr Zhang to CMC itself, or to CMC's legal representatives; and it is perfectly possible to imagine a wide variety of circumstances in which something derogatory or unfavourable might be said which would amount to a breach of the terms of the settlement, but would only sound in damages to a very modest degree. What then is the requirement for the payment of US$40,000? How is that to be regarded?

17. Mr Westgate has bravely sought to read down the agreement of 7 August so as to make it more palatable. I am sorry to say that from my point of view, he has failed to do that. It is quite impossible, I would say, to read the provisions to which I have just referred as being other than a penalty within the terms identified by Lord Dunedin or Colman J. This was included as a deterrent. That it was so is reinforced by the further observation in the letter that there could be an additional claim for damages, and I quote, "Such a claim could be considerable." It is, in my view, quite impossible to read the letter as containing other than a penalty clause. At one time, although I am not sure it has been pursued before us today, reliance was placed on Alder v Moore [1961] 2 QB page 57. That was a case where an insurance company paid a sum of money to a professional footballer who suffered injury and whom it was thought would never be able to play professional football again. There it was made a condition of the payment of £500, I believe, that should he find it was possible for him to play football again professionally, that sum would be returned to the insurers. As matters turned out, and happily, it was possible for Mr Moore to play football again and the insurers claimed back the sum which had been paid. It was said on behalf of Mr Moore that the payment had been a penalty. Not so, said the court. It was a claim for repayment as agreed for a sum of money on the happening of a certain event. It did not depend upon any breach of contract. That was explained clearly, I believe, in Jervis v Harris [1996] Ch 195 at page 206. There Millett LJ, as he then was, said towards the top of the page:

> "Clause 2(10) is not a penalty clause because it provides for the payment of a sum

> of money upon the happening of a specified event other than a breach of a contractual duty owed by the party liable to make the payment to the party entitled to receive it".

And a little later on the same page:

> "it is well settled that the event on which the sum alleged to be a penalty becomes payable must be a breach of some other contractual obligation owed by the obligor to the obligee".

18. So Mr Westgate finds no comfort in that authority and it follows from what I have said, and my holding that this was a penalty, that in my view the application must be allowed and if the appeal is to follow, that should be allowed also. With what consequences? Mr Westgate has made it plain that he does not in any circumstances wish the matter to be remitted to the Master. I can well understand why CMC take that attitude. It may very well be that the consequences will become a matter for further argument, and for the time being I say no more.

19. LORD JUSTICE DYSON: I agree. I simply want to add a few words on the penalty point. Mr Westgate's principal submission is that the settlement agreement contained in the letter of 7 August 2003 should be construed as providing for the payment of US$40,000 by CMC, conditional upon Mr Zhang observing the terms set out in paragraphs numbered 1, 2 and 3 of the letter. He submits that the agreement provided that, if there was any breach of these terms, then the conditions subject to which the payment was made were defeated and the US$40,000 became repayable. If that were the proper construction of the agreement, I would accept that there would be no question of the provision for repayment of US$40,000 being a penalty and therefore unenforceable.

20. But I find it impossible to construe the agreement as having that effect. The language of the last paragraph shows that it was intended that the US$40,000 was repayable as part of the compensation due to CMC in the event of "any breach of this settlement and agreement". As the document states, in the event of such a breach Mr Zhang would be "liable" to pay the sum of US$40,000:

> "… together with a claim for reimbursement of our legal costs against you in addition to a claim for damages in relation to loss of business."

21. Mr Westgate has also suggested that the agreement to pay US$40,000 plus costs plus damages for loss of business was not a penalty, because it was no more than an agreement that in the event of a breach of any of the terms in paragraphs numbered 1, 2 or 3, the US$40,000 would be repayable on the grounds that there had been a total failure of consideration. I cannot read the agreement in this way. It seems to me to be plain that upon its true construction the agreement provides that in the event of any breach of its terms by Mr Zhang, he should pay compensation to include repayment of the US$40,000. The question then becomes whether that provision was a penalty. For the reasons given by my Lord, I would hold that it was a penalty. The substantial sum of US$40,000 was

repayable for any breach, no matter how trivial. It is difficult to see what losses, other than those in relation to loss of business, CMC would itself suffer for any breach of the terms stated in the letter, and the agreement provides for the recovery of those losses in addition to the repayment of the US$40,000.

22. In this connection it is salutary to have in mind paragraph 4(c) of the speech of Lord Dunedin in the Dunlop Pneumatic Tyres case where he said that there was a presumption that it is a 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."

It seems to me that this paragraph is wholly apt in the circumstances of this case. It seems to me that Mr Westgate has not rebutted the presumption. For these reasons, in addition to those given by my Lord, I would allow this appeal.

23. LORD JUSTICE MUMMERY: For the reasons given by Sir Charles Mantell and my Lord, Dyson LJ, I agree that permission to appeal should be granted and that the appeal should be allowed.

24. I only wish to add short comments on three points. The first is very short, but nonetheless important. This court is indebted not only to Mr Westgate, who presented clear and concise arguments on behalf of CMC, but particularly to Mr Hossain, who has been instructed by the Bar Pro Bono Unit pursuant to a suggestion made by Waller LJ when adjourning this matter to the full court. It is no exaggeration to say that, without the benefit of his invaluable skeleton argument and his helpful oral submissions, it would have been extremely difficult for this court to deal with Mr Zhang's application.

25. Secondly, I wish to say a few additional words about the point taken by Mr Westgate that it was not possible for the penalty point to be canvassed on this appeal because it had been raised for the first time on the appeal and after the default judgment. I do not wish to add anything to what Sir Charles Mantell has said about the ability of a litigant in person to be allowed to take a new point on an appeal, which is of substance and relates to a matter of law which he was ill equipped to canvass himself when he was unrepresented before the Master.

26. As to the effect of the default judgment, I agree with what Sir Charles Mantell has said. Mr Westgate cited a passage from the judgment in Carbopego v Amci Export Corporation [2006] EWHC 72, paragraphs 14 to 17, relating to the matters that are necessarily determined by a default judgment. It was submitted by Mr Westgate that the default judgment had in this case determined the issue of liability and that the penalty argument raised an issue of liability rather than an issue of quantification.

27. In my judgment, the passage that he relied on does not support this argument. It is clear that questions relating to both causation of damage and quantification of damage are not

determined by a default judgment. In this case, we only have to look at the default judgment to see that his argument is wrong. What was ordered was that Mr Zhang should pay to CMC "an amount and costs which the court will decide". When the matter came before the master on 5 April 2005 the question he had to address, among other matters, was whether the amount of US$40,000 was to be included in the quantification of the damages claimed by CMC for breach of the agreement. The Master decided that that amount should be included, and accordingly gave judgment for that sum as well as for an additional sum of £1,000 damages. In our view he was not right to include that because, being a penalty, the sum of US$40,000 was not an amount which the court should have decided to award in its judgment to CMC.

28. The third matter on which I wish to add a short comment is the penalty argument. It seemed to me that what Mr Westgate was trying to do, quite naturally, was to distinguish this case from the cases of Dunlop and Murray. He was saying that this is not like an ordinary commercial agreement as one had in Dunlop; and being a compromise, it was different from the sort of agreement – namely a service contract – that was considered in Murray. He suggested that this was some kind of midway situation in which it was possible to say that, even though it was not a genuine pre-estimate of damages, it was something else that was not caught by the penalty cases. What he was saying, I think, was that this was a case which provided under a compromise for a payment to be made on a specified basis – that was paragraphs 1, 2 and 3 of the compromise agreement – and then provided for repayment of the sum that was paid, if that basis of the payment fell away. That would be the case here if Mr Zhang failed to comply with what he had agreed to do, or not to do, in the three paragraphs which I have mentioned.

29. In my judgment, that argument does not succeed, for the reasons given by Dyson LJ. On the proper construction of the last paragraph of the agreement, read as a whole, this is a case in which payments to be made by Mr Zhang are linked to breaches of the agreement and they come within the penalty cases. I agree with the analysis put forward by Mr Hossain that in this case, a lump sum of US$40,000 was payable in the event of any breach of the compromise agreement. The agreement could be breached in very trifling ways, such as those mentioned by Sir Charles Mantell. No attempt was made in the agreement to tailor the sum which was payable to the different circumstances in which the compromise agreement could be breached. CMC was not making a genuine attempt to estimate its loss. If it was not a genuine attempt to estimate, before a breach, what amount of compensation should be paid, then it is open for the court to decide that what has been provided for is a deterrent to breach rather than a genuine pre-estimate of the compensation to be paid on a breach. In this case, what is provided for is payment of an extravagant or unconscionable sum of money in events which could be very minor breaches of the agreement.

30. For those reasons, as well as for the reasons given by my Lords, I conclude that this is a penalty and that it cannot be recovered by CMC in these proceedings. I would also grant leave to appeal, and then allow the appeal in relation to the judgment for US$40,000.

Order: Appeal allowed.