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Liquidated Damages or Unenforceable Penalty? The Perils of Charging Administrative Fees for Breach of Contract

A contractual provision which entitles a party to an excessive administrative charge on default may be considered an unenforceable penalty clause. Notwithstanding parties' general freedom to negotiate their own remedies, Courts will find overly onerous damages provisions unenforceable. This was exactly the situation in *RCAP Leasing Inc v Martin*.

In that case, the defendant was a lessee of a road grader. Approximately three years into the lease, the defendant defaulted in payment under the lease.

The lease agreement stipulated that the defaulting lessee would pay to the lessor an administrative fee of 15% of the total payable under the agreement, which totalled approximately \$37,500. The contract described the fee as "compensation for additional administrative and clerical work" related to the lessee's default.

The issue before the Court was whether the clause constituted a genuine pre-estimate of liquidated damages (which would be enforceable) or a penalty clause (which would not). The Court concluded that it fell into the latter category.

The Court held that the clause was problematic because of its broad scope: namely, it was triggered whenever the lessee fell into default and failed to cure that default within five days of the demand for payment. The clause failed to modify damages in any way to take into account what actually occurred in the event of default by the lessee. This made it "an extravagant, unconscionable and oppressive provision", which the Court struck down as an unenforceable penalty clause.

Having struck down the damages clause, the Court was limited to award the damages that the Plaintiff had proved. The Court awarded a total of \$5,000 in damages for increased administrative expenses actually suffered by the lessor rather than the much larger amount stipulated in the contract.

This decision shows the continued importance of ensuring that clauses by which parties have agreed in advance to damages in the event of breach are enforceable. Parties can increase the

likelihood that such clauses will be enforced where those clauses quantify damages based on the nature of breach. However, where they are not enforceable, plaintiffs may be left with a much lower quantum of damages.

With notes from Chloe Boubalos