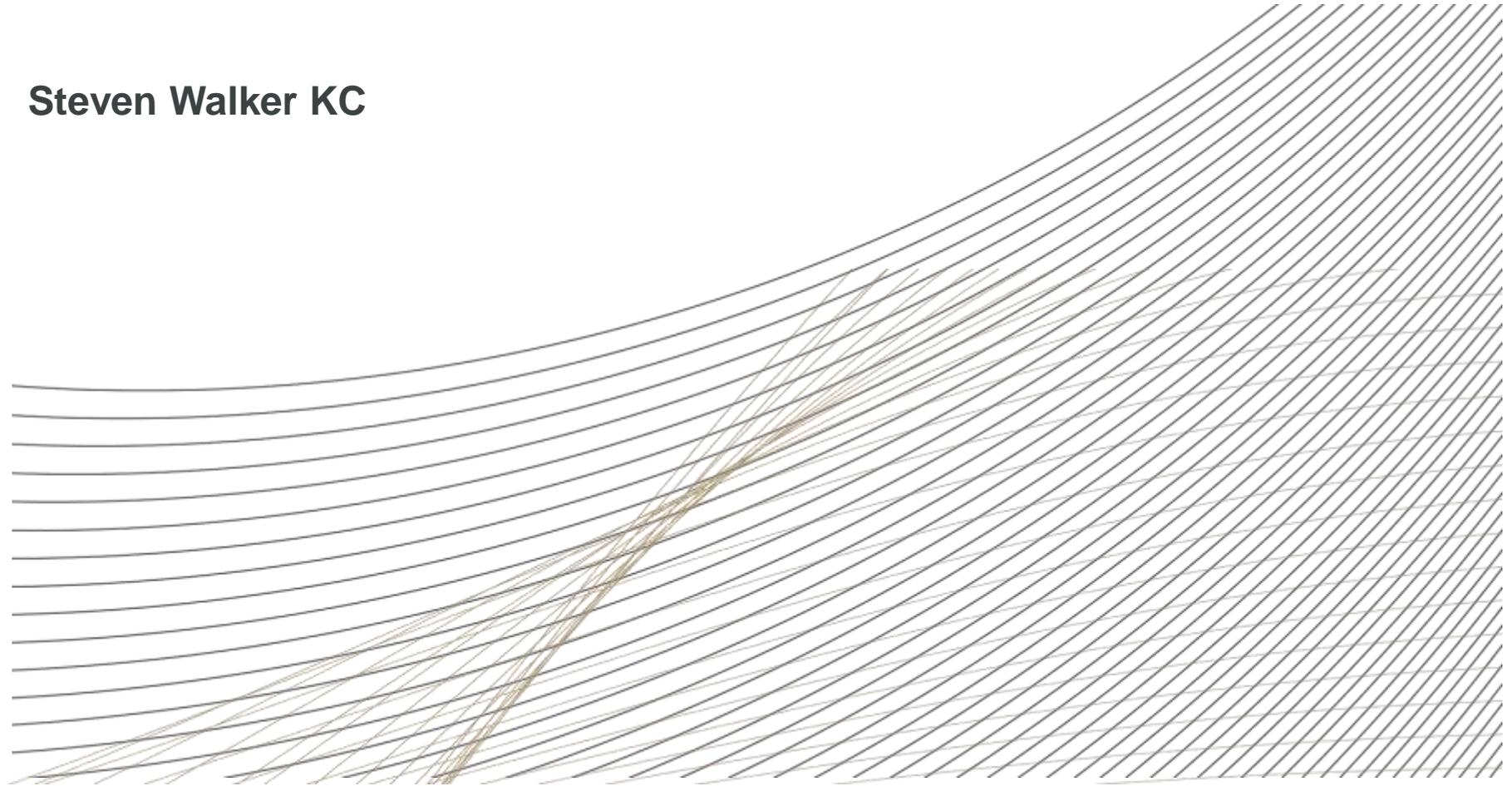


How enforceable are liquidated damages following the spate of legal cases? What makes a difference?

Steven Walker KC



**Atkin
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Barristers

Introduction

- (1) The penalty rule.
- (2) When is the penalty rule engaged?
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(1) The penalty rule

Cavendish Square Holding BV v Makdessi

ParkingEye Ltd v Beavis [2015] UKSC 67; [2016] AC 1172

“The penalty rule regulates only the remedies available for breach of a party's primary obligations, not the primary obligations themselves”

Per Lord Neuberger and Sumption JSC at [13].

(2) When is the penalty rule engaged?

- The penalty rule only applies to a secondary obligation.
- Where a contract contains an obligation on one party to perform an act, and also provides that, if he does not perform it, he will pay the other party a specified sum of money, the obligation to pay the specified sum is a secondary obligation which is capable of being a penalty.
- Secondary obligations that take other forms may be capable of being a penalty.

(3) The test

A provision is penal if it is a secondary obligation which imposes a detriment on the contract-breaker out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation.

See *Makdessi*.

(4) Application of the test to liquidated damages for delay

Points for consideration:

- (i) Was the alleged penalty negotiated by the parties?
- (ii) Were the parties to the negotiation legally represented?
- (iii) What detriment might breach of the primary obligation be liable to cause to the innocent party?
- (iv) How easy or difficult would it be to calculate the loss suffered by the innocent party due to breach of the primary obligation?
- (v) Is the level of damages extravagant, exorbitant or unconscionable?
- (vi) Waiver clauses.
- (vii) Clarity of drafting.

(i) Negotiation

In a negotiated contract between properly advised parties of comparable bargaining power, the strong initial presumption has to be that the parties themselves were the best judges of what was legitimate in a provision dealing with the consequences of breach.

See ***Eco World-Ballymore Embassy Gardens Co Ltd v Dobler UK Ltd*** [2021] EWHC 2207 (TCC) at [80].

See also ***Mansion Place Ltd v Fox Industrial Services Ltd*** [2021] EWHC 2972 (TCC) at [89] (obiter).

(ii) Legal advice

If the parties were legally advised during the contract negotiations, that is likely to reinforce the strong initial presumption in favour of upholding the provision.

See *Eco World-Ballymore* at [81].

(iii) Detriment due to delay

The detriment suffered will vary according to the facts of the case. For example, in the case of a residential development losses will typically include:

- (1) Loss of income.
- (2) Additional financing costs.
- (3) Additional management and overhead costs.
- (4) Potential liabilities to buyers/tenants.

(iv) Difficulty of quantification

“Such a clause serves two useful purposes. First, establishing what financial loss delay has caused the employer would often be an intractable task capable of giving rise to costly disputes. Fixing in advance the damages payable for such delay avoids such difficulty and cost. Second, such a clause limits the contractor’s exposure to liability of an otherwise unknown and open-ended kind, while at the same time giving the employer certainty about the amount that it will be entitled to recover as compensation. Each party is therefore better able to manage the risk of delay in the completion of the project.”

Per Lord Leggatt JSC in ***Triple Point Technology, Inc v PTT Public Company Ltd*** [2021] UKSC 29 at [74].

(v) Proportionality

“For instance, if you agreed to build a house in a year, and agreed if you did not build the house for £50, you were to pay a million of money as a penalty, the extravagance of that would be at once apparent”.

Per Earl of Halsbury L.C. in ***Clydebank Engineering & Shipbuilding Co Ltd v Yzquierdo y Castaneda*** [1905] AC 6.

(vi) Waiver clauses

Buckingham Group Contracting Ltd v Peel L&P Investments and Property Ltd [2022] EWHC 1842 (TCC)

The contract provided:

“...having given careful consideration to this matter, all LADs payable by the Contractor are considered by the Parties to be a genuine pre-estimate of the losses [...]; arrived at without any inequality of bargaining position as between the Parties as a true bargain between the Parties; fair, given the nature and circumstances of the agreement; neither excessive, extravagant, unconscionable or oppressive in all the circumstances; and [...] the Contractor waives absolutely any entitlement to challenge the enforceability in whole or in part of the liquidated damages provision....”

At [89] the Judge said in circumstances where Buckingham might have been contending that the rates for liquidated damages in Schedule 10 were penal, the effect of this clause could potentially have been significant.

(vii) Clarity of drafting

The courts will not readily find provisions void for uncertainty.

Technical objections to the operation of provisions for liquidated damages may face an uphill struggle: see ***Buckingham Group*** in which the court had to resolve a number of ambiguities in the drafting of the provisions relating to liquidated damages when considering whether those provisions were void for uncertainty.

(5) Partial possession cases

See ***Eco-World-Ballymore*** at [77]:

“In some cases the use of a single rate of liquidated damages payable regardless whether 10% or 90% of a development is handed over, or completed, after the contractual date for completion, might indicate that the liquidated damages provision amounted to a penalty; but in other cases, it might not.” It was held that the use of the same rate of liquidated damages as compensation for late completion of any combination of Blocks A, B and/or C was not penal, despite the fact that different levels of loss would be incurred.

See also ***Mansion Place v Fox*** in which the decision in ***Brammall & Ogden v Sheffield City Council*** (1986) 29 BLR 73 was distinguished.

(6) If the clause is void, can it act as a cap on general damages?

“In Keating and Hudson it is noted that there is merit in treating the liquidated damages cap as an agreed limitation on damages for the benefit of the contractor. The editors of McGregor consider that the charterparty line of authority is clear and dicta suggesting the penalty acts as a cap are wrong.”

Per O’Farrell J. DBE in ***EcoWorld-Ballymore*** at [102].

(6) If the clause is void, can it act as a cap on general damages?

Eco World-Ballymore

The contract stated “*Liquidated damages will apply ... at the rate of £25,000 per week (or pro rata for part of a week) up to an aggregate maximum of 7% of the final Trade Contract Sum...*”.

Obiter: “*the court would strive to give effect to the separate part of the provision containing an express limitation on liability at 7% of the final Trade Contract Sum.*”

Per O’Farrell J. DBE at [116].

(6) If the clause is void, can it act as a cap on general damages?

Buckingham Group Contracting Ltd

The contract included a “Cap on Maximum LADs” of 7.5% of the Trade Contract.

Obiter, the Judge said this:

“The cap is “on Maximum LADs”, not on anything other than LADs. There is nothing within clause 2.29A (the key provision which triggers the application of Schedule 10) which suggests that any alternative liability for any general damages would be capped. If the suggestion is that the cap within Schedule 10, rendered operative by clause 2.29A, should operate as a cap for breach of an entirely different obligation, such as clause 2.3, that would be a most surprising place in which to find it located. Instead, the cap sits within a Schedule exclusively concerned with Milestone Dates and individual rates for liquidated damages applicable thereto. Both are the product of clause 2.29A and, in line with Makdessi, should stand or fall together.” See [96].

(7) Conclusions

The Courts are very reluctant to find that liquidated damages clauses in construction contracts made between commercial entities are penal or void for uncertainty.

The question whether an unenforceable clause acts as a cap on general damages will turn on the proper construction of the clause in question.



Steven Walker KC

Silk 2012

Steven Walker KC specialises in advising and representing parties to complex commercial contracts relating to a wide range of subject matter including the design and delivery of buildings, oil and gas installations, power generation plant, process and engineering plant, ships, IT systems, telecommunications systems, PFI/PPP, facilities management and professional services.

Steven has extensive experience in the energy sector having been heavily involved in a number of projects concerning the design and construction of offshore wind farms, energy from waste plants and other forms of renewable energy.

Transport-related projects have formed an important part of Steven's practice over the past 25 years. His first case in the sector concerned the Eurostar high-speed train sets and since then he has been involved in numerous projects in the road, rail and air sectors including the construction of the HS1 high-speed rail link, airport runways and other airport infrastructure, overground and underground rail and tram systems, road construction/extension, and communication systems.

He has appeared as advocate in the Technology and Construction Court (TCC), the Court of Appeal, numerous arbitrations (including ICC, DIAC, UNCITRAL, HKIAC, LCIA and LMAA) and adjudications, and in expert determination and mediation. His arbitration experience includes substantial international experience.

Atkin Chambers

1 Atkin Building

Gray's Inn

London

WC1R 5AT

United Kingdom

Telephone

+44 (0)20 7404 0102

Email

clerks@atkinchambers.com

atkinchambers.com

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