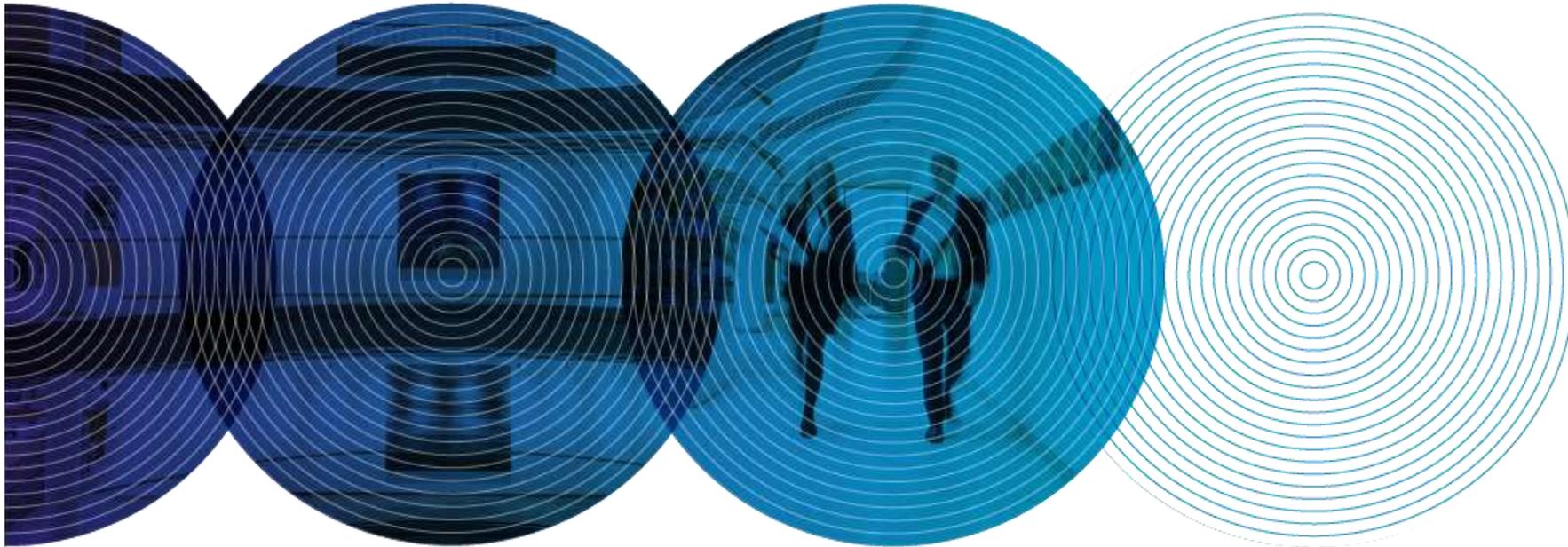

Liquidated Damages

What factors are taken into account when considering liquidated damages claims

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Sean Carr, Partner



What are liquidated damages?

- Liquidated damages are an exact amount of money, or a set formula to calculate the amount of money, a party will owe if it breaches a contract, in order to compensate the injured party for its losses.
- In the construction sector, liquidated damages are the agreed measure of loss payable by the contractor to the employer for any contractor responsible delay.

Why agree liquidated damages?

- Certainty.
- The employer does not then have to quantify its loss.
- Limit the contractor's exposure.
- Manage the risk of delay.

Could a liquidated damages clause be a penalty clause?

- What is a penalty clause:
 - A penalty clause is a clause that calls for a penalty to be paid or suffered by a party in the event of a breach of contract.
 - Common law rule against penalties.

Penalty Clauses - Caselaw

- *Gilbert-Ash (Northern) Ltd v Modern Engineering (Bristol) Ltd* [1974] AC 689.
 - The House of Lords, in the UK, considered a provision in a building sub-contract which entitled a contractor to “suspend or withhold” the payment of money due to a sub-contractor upon any breach of contract. Could a liquidated damages clause be a penalty clause?
 - *“If the sub-contractor fails to comply with any of the conditions of this sub-contract, the contractor reserves the right to suspend or withhold payment of any monies due or becoming due to the subcontractor.”*

- Obiter comments (i.e. not binding)
 - *“There is no reference to the amount of the contractor’s claim in respect of breaches of contract and no requirement that before withholding payment he need even estimate the amount of his claim. Read literally this provision would entitle the contractor to withhold sums far in excess of any fair estimate of the value of his claims. That would simply be to impose a penalty for refusing to admit his claims. Not only would the withholding of the excess permanently deprive the sub-contractor of the interest on that excess which would accrue while the dispute lasted, but it might have most damaging effects on the sub-contractor’s business. So, as it stands, this provision is unenforceable.”*

What test will the court apply?

- UK decision of *Dunlop Pneumatic Tyre v. New Garage* [1915] A.C. 79 1 (cited with approval in *Pat O'Donnell & Co v. Truck and Machinery Sales* [1998] WJSC-SC 11287 and as the law in Ireland):
 - “Though the parties to a contract who use the words “penalty” or “liquidated damages” may prima facie be supposed to mean what they say, yet the expression used is not conclusive. The Court must find out whether the payment stipulated is in truth a penalty or liquidated damages. This doctrine may be said to be found passim in nearly every case.
 - The essence of a penalty is a payment of money stipulated as in terrorem [into/about fear] of the offending party; the essence of liquidated damages is a genuine covenanted pre-estimate of damage (*Clydebank Engineering and Shipbuilding Co. v. Don Jose Ramos Yzquierdo y Castaneda*).
 - 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 (*Public Works Commissioner v. Hills and Webster v. Bosanquet*).

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- To assist this task of construction various tests have been suggested, which if applicable to the case under consideration may prove helpful, or even conclusive. Such are:
 - It will be held to be 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. (Illustration given by Lord Halsbury in Clydebank Case).
 - It will be held to be a penalty if the breach consists only in not paying a sum of money, and the sum stipulated is a sum greater than the sum which ought to have been paid (Kemble v. Farren 34). ...
 - 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” (Lord Watson in Lord Elphinstone v. Monkland Iron and Coal Co. 36).

On the other hand:

- *It is no obstacle to the sum stipulated being a genuine pre-estimate of damage, that the consequences of the breach are such as to make precise pre-estimation almost an impossibility.* On the contrary, that is just the situation when it is probable that pre-estimated damage was the true bargain between the parties (Clydebank Case, Lord Halsbury 37 ; Webster v. Bosanquet Lord Mersey 38).”

Summary Liquidated Damages Test

- It is a matter for the court to consider based on the wording of the clause.
- The level of damages must be a genuine pre-estimate of the losses.
- Whether the damages are a genuine pre-estimate will be judged from the time the contract was entered into.
- It will be a penalty if the damages are extravagant and unconscionable in comparison with the greatest loss that could conceivably be proved.
- It will be presumed to be a penalty if the amount payable is the same irrespective of whether the breach is serious or minor.

Updated Caselaw

- *Cavendish Square Holding BV v Talal El Makdessi and ParkingEye Limited v Beavis* [2015] UKSC 67 **(UK Position)**
 - “The true test is whether the impugned provision 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. The innocent party can have no proper interest in simply punishing the defaulter. His interest is in performance or in some appropriate alternative to performance. In the case of a straightforward damages clause, that interest will rarely extend beyond compensation for the breach, and we therefore expect that Lord Dunedin’s four tests would usually be perfectly adequate to determine its validity. But compensation is not necessarily the only legitimate interest that the innocent party may have in the performance of the defaulter’s primary obligations. ...”

- Sheehan v Breccia [2018] I.E.C.A. 286 (**Irish Position**)
 - “The High Court and this Court remain bound in accordance with the Supreme Court judgment in Pat O’Donnell to apply the Dunlop principles in determining whether the surcharge interest clause is or is not a penalty. In so stating **I do not wish to be taken as indicating that a reconsideration of those principles in the 21st century by the Supreme Court** certainly insofar as they relate to additional default or surcharge interest **may not be desirable. However, that remains a matter for the Supreme Court in this jurisdiction**”

When might a liquidated damages clause be void for uncertainty?

- **Eco World – Ballymore Embassy Gardens Co Ltd v Dobler UK Ltd [2021] EWHC 2207**
 - Amended JCT 2011 Construction Management Trade form *“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...”*
 - The works had not been completed by the contractual completion date of 30 April 2018. On 15 June 2018 Eco World took over two blocks and the entirety of the works were later certified as practically complete in December 2018.
 - No mechanism in the contract for a corresponding reduction in liquidated damages in the event of such partial possession.

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- Mrs. Justice O’Farrell applied the test set out in *Cavendish Square Holding BV v Makdessi* [2015] UKSC 67, namely, whether a liquidated damages clause is enforceable depends on whether it is unconscionable or extravagant so as to amount to a penalty. Mrs. Justice O’Farrell decided it did not amount to a penalty for the following four reasons:
 - The liquidated damages provision was negotiated by the parties, who both had the benefit of advice from external lawyers;
 - Eco World had a legitimate interest in enforcing the primary obligation of Dobler: to complete all of the works by the agreed completion date;
 - By fixing the rate of liquidated damages for late completion of the works as a whole, the parties avoided the difficulty of calculating and proving losses suffered by Eco World where only part of the works were completed; and
 - The level of liquidated damages, i.e. £25,000 per week, after a 4-week grace period and up to a maximum of 7% of the contract sum, was reasonable and proportionate.

- Obiter comments:
 - Mrs. Justice O’Farrell also opined that even if the liquidated damages clause was void or unenforceable, on a proper construction of the clause, a contractual cap on liquidated damages could operate to limit any general damages.
 - While not required to address this question, given the liquidated damages clause was valid, the Court considered that to limit the application of the cap solely to liquidated damages would be too literal. The clear intention of the parties was: (i) to apply a rate of liquidated damages; and (ii) to limit Dobler’s liability for delay damages to a specific percentage of the final contract sum whether pursuant to liquidated damages or general damages.
 - *“Liquidated damages will apply....at the rate of £25,000 per week (or pro rate for part of a week) up to an aggregate maximum of 7% of the final Trade Contract Sum...”*

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

- Facts:
 - Buckingham Group were contracted by Peel L&P, to construct a new plant at Ellesmere Port in Merseyside pursuant to a contract dated 29 January 2018.
 - The contract was based on the JCT Design and Build Contract 2016 with various bespoke amendments specific to the project, including a regime for the payment of liquidated damages for delay (Schedule 10).
 - Schedule 10 to the Contract set out dates for completion of certain milestones including for Practical Completion. The schedule also specified weekly amounts for delays to each milestone along with an overall cap on liquidated damages. It provided that *“If there is any conflict or inconsistency between the wording of this schedule and clause 2.29 the wording of this schedule shall take precedence;*
 - Buckingham Group claimed that the liquidated damages regime was uncertain and therefore void and/or unenforceable due to alleged errors concerning the date of practical completion, the rates, the Contract Sum, and sectional completion.

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- The Date for Completion
 - The Contract Particulars provided a Date for Completion of 1 October 2018;
 - Schedule 10 provided a Date for Completion of 30 November 2018
 - Held:
 - the Contract provides an obligation on the contractor to complete the works by 1 October 2018 and applies liquidated damages to that breach from 30 November 2018

- The rate of liquidated damages in Schedule 10

- Schedule 10 is titled “ LADs Proposal”.

Description	Sectional Milestone	LADs Per Tender Schedule 10		BGCL LADs Proposal Ref BAFO Lts 13.7.17	
		% of CSA/day	£/wk	% of CSA/day	£/wk
Installation of Utilities	01/08/2018	0.075%	£134,000	0.038%	£67,400

- Held:

- At the time of its preparation, Schedule 10 was a proposal included with the tender documents. The rates of liquidated damages could be easily identified as: (i) the tender proposal rates; and (ii) the Contractor’s proposed rates.
- By including Schedule 10 in the Contract, the parties acknowledged that the proposal was now an agreement. The applicable rates were those made last in time; namely those identified as the Contractor’s proposed rates.

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- The Contract Sum
 - The Contract Particulars provided a Contract Sum of £26,164,049.28;
 - Schedule 10 provided a Contract Sum of £25,710,050.28.
 - Held:
 - The rates of liquidated damages were clear notwithstanding the difference between the Contract Sum in the Contract Particulars and Schedule 10 – they were by reference to the identified sum and not by reference to a percentage of the Contract Sum;

- Sectional Completion
 - Clauses 2.30 – 2.34 allowed for sectional completion;
 - Schedule 10 contained sectional milestones but did not provide a mechanism for calculating a reduction in the rate of liquidated damages in the event that sections were completed and handed over.
- Held:
 - The sectional milestones in Schedule 10 were not referenced elsewhere in the contract and therefore there was no entitlement to partial possession;
 - They were drafted in such a way that it would have been impossible to obtain possession following completion certain of those milestones (e.g. some work (such as drainage) cut across different milestones). There were more correctly stages of construction rather than sections.
 - As the Contract did not provide for sectional completion, there was no requirement for a mechanism to calculate a reduction in the rate of liquidated damages.

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- Cap on Liability
 - Buckingham Group also argued, following the decision in *Eco World v Dobler* that, in the event that the liquidated damages regime was found to be void for uncertainty, the cap on liquidated damages also applied as a cap on general damages for delay.
 - In this Contract, Schedule 10 expressed the cap on the following terms “*Cap on Maximum LDs*” and the Court found there was no rationale for reading this term more generally to cover general delay damages.
 - The Court held that “*one simply has to consider whether the language of the provision was broad enough to encompass any alternative liability that could arise in respect of general damages.*”
 - Considering the wording of the cap itself and the fact that the cap was contained in a schedule to the Contract which dealt exclusively with liquidated damages, the court concluded that it applied only to the LDs and was of no wider application.

Tripple Point Technology Inc v. PTT Public Company Ltd [2021] UKSC 29

- Contract for the design, installation, maintenance and licencing of software provided by Tripple Point to PTT for the purposes of PTT's business of commodity trading
 - Article 5.3: *“If CONTRACTOR fails to deliver work within the time specified and the delay has not been introduced by PTT, CONTRACTOR shall be liable to pay the penalty at the **rate of 0.1% (zero point one percent) of undelivered work per day of delay from the due date for delivery up to the date PTT accepts such work**, provided, however, that if undelivered work has to be used in combination with or as an essential component for the work already accepted by PTT, the penalty shall be calculated in full on the cost of the combination.”*
- Question 1 – Are liquidated damages payable when the works are never accepted?

- Question 1 – Are liquidated damages payable when the works are never accepted?
- Held:
- *“In the instant case, **article 5.3 of the Main Part on its true construction provided for liquidated damages if Triple Point did not discharge its obligations within the time fixed by the contract irrespective of whether PTT accepted any works which were completed late.** The function of the words on which the Court of Appeal relied was to provide an end date for liquidated damages on acceptance of the works by PTT to ensure that in that event there was no further claim for liquidated damages in respect of the relevant delay. **But it did not follow that there were to be no liquidated damages if there was no such acceptance. To reach that conclusion would be to render the liquidated damages clause of little value in a commercial contract.** To use an idiomatic phrase, the interpretation accepted by the Court of Appeal in effect threw out the baby with the bathwater”*

Tripple Point Technology Inc v. PTT Public Company Ltd [2021] UKSC 29

- Article 12.3: “... **The total liability of CONTRACTOR to PTT under the Contract shall be limited to the Contract Price received by CONTRACTOR with respect to the services or deliverables involved under this Contract.** Except for the specific remedies expressly identified as such in this Contract, PTT’s exclusive remedy for any claim arising out of this Contract will be for CONTRACTOR, upon written notice, to use best endeavor to cure the breach at its expense, or failing that, to return the fees paid to CONTRACTOR for the Services or Deliverables related to the breach. **This limitation of liability shall not apply to CONTRACTOR’s liability resulting from fraud, negligence, gross negligence or wilful misconduct of CONTRACTOR or any of its officers, employees or agents.**”
- Question 3 – Are liquidated damages subject to the cap in Article 12.3?

- Question 3 – Are liquidated damages subject to the cap in Article 12.3?
- Held:
- *“I do not accept that the exception for special remedies in the third sentence extends to the second sentence dealing with the global cap. **On my interpretation, the second and third sentences of article 12.3 serve separate functions** and are in logical order. **First there is a limitation on liability and, second, there is a limitation on the form of remedy.** The limitation on the form of remedy contains an exception for special remedies under the contract, of which the liquidated damages clause would be one. But that does not mean to say that the same exception should be written into the limitation on liability. Accordingly, I would reject PTT’s appeal on this point.”*

- Question 2 – Does the cap on liability apply to a negligent breach of contract?
- Held:
- *“In my judgment **the cap carve-out** in the final sentence of article 12.3 for all the reasons given above **should be given its natural and ordinary meaning of removing from the cap all damages for negligence on Triple Point’s part, including damages for negligent breach of contract.** That means that in my judgment the judge and the Court of Appeal were wrong to treat damages for breach of the contractual duty of skill and care as subject to the cap in article 12.3 of the Main Part of the CTRM Contract”*

- Liquidated Damages and Termination (Lord Leggatt)
- *“I conclude that it is ordinarily to be expected that, unless the clause clearly provides otherwise, a liquidated damages clause will apply to any period of delay in completing the work up to, but not beyond, the date of termination of the contract.”*
- *“... **the term “delay”** would in my view reasonably be understood to refer to **delay by the Contractor** - that is to say, **any period of time when the Contractor is under an obligation to deliver work** with which it has failed to comply. Accordingly, if the Contractor ceases to be under an obligation to deliver work because the **Contractor is discharged from that obligation by the termination of the contract**, no further liability to pay the sum payable for each day of delay in the performance of that obligation will arise. However, termination of the contract will not affect the liability of Triple Point to pay liquidated damages for each day of delay in the performance of its obligation to deliver work under the contract which had already occurred before the contract was terminated.”*

Fundamental Breach

- Clayton Love & Sons (Dublin) Ltd. v. British & Irish Steam Packet Co. Ltd. (1970) 104 I.L.T.R. 157
- The leading Irish Supreme Court case of Clayton Love held that it was not possible to exclude liability for a fundamental breach of contract. The Court outlined that a breach of a fundamental term would have the practical effect of *“the service [the plaintiffs] received...being something radically different from the service [which they had] contracted.”*
- *ESL Consulting Services Ltd. v. Verizon (Ireland) Ltd.* [2008] IEHC 369 Finlay Geoghegan J in the High Court acknowledged that she was bound by Clayton Love, Finlay Geoghegan J but stated:
 - *“I would add that if I was free to decide the issue in light of subsequent judgments in other jurisdictions, as has been observed already by a number of my colleagues in the High Court, there appears to be strong arguments in favour of the reconsideration of the application of the so called doctrine of fundamental breach to agreements between two commercial entities for the reasons outlined by the House of Lords in [Photo Production].”*

Conclusion

- Is the clause enforceable?
 - Is it a penalty? (Genuine Pre-Estimate of Loss / does it impose a detriment out of all proportion to any legitimate interest in the enforcement of the contract?)
 - Is it void for uncertainty?
- If liquidated damages are unenforceable – is the liability unlimited?
- Consequences of termination on liquidated damages – does this impact a cap on liability
- Fundamental breach?

Questions?



Principal Office

Riverside One, Sir John Rogerson's Quay
Dublin 2 D02 X576
+353 1 829 0000

London

Tower 42, Level 38C, 25 Old Broad Street
London EC2N 1HQ
+44 20 7621 1000

New York

One Rockefeller Plaza, 30th Floor
New York, NY 10020
+1 646 952 6001

Brussels

40 Square de Meeûs, 1000 Brussels
+32 2 740 0370

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