

LIQUIDATED DAMAGES – EXPLODING THE MYTHS¹

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Introduction

1. A question laden with jurisprudential tension, rich in judicial commentary and of fundamental legal, practical and commercial significance for 'construction lawyers' and decision makers is this:

"To what extent does English contract law allow parties to a contract to specify for their own remedies in damages in the event of breach?"

2. Put simply, penalty clause remedies *are* not allowed but liquidated damages clauses *are* allowed². This so-called 'rule against penalties' is an exception to the general principle of English law that a contract should be enforced in accordance with its terms³.

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² It is generally accepted that liquidated damages clauses have benefits for both parties to a contract. However, there are *some* authors who state otherwise. For example, *It's a lads thing* Tony Bingham in *Building* 28.11.08:

"Lawyers tend to explain what a good thing they are, because they let everyone know the exact sum to be shelled out and allow the contractor to foresee the precise consequences of delay.

This is rubbish. Contractors utterly loathe LADs, no matter what unlikely fancy dress you stick them in. They are a sword hanging by a hair directly above their head. Try to persuade any contractor that they are not penalties and you will fail. And knowing that late completion is going to snap the thread leads to all sorts of disputes. I reckon the neon sign of "LAD" does more harm than good."

³ See for example the comments of Chadwick LJ in *Euro London Appointments Ltd v Claessens International Ltd* [2006] 2 Lloyd's Rep 436.

3. This prohibition⁴ of the penalty clause is said to be consistent with the English Law treatment of damages: damages are compensatory and that to allow a clause which in turn allows recovery of sums in excess of the actual loss suffered or sufferable would be wrong. In the latter case the sum would be more of a deterrent (designed to discourage breaches of contract or to secure performance by the contractor). This is clear in the statement of Lord Roskill⁵

“Perhaps the main purpose of the law relating to penalty clauses is to prevent a plaintiff recovering a sum of money in respect of a breach of contract committed by a defendant which bears little or no relationship to the actual loss actually suffered by the plaintiff as result of the breach by the defendant...”

and in the statement of Arden LJ⁶

“...So far as pre-determined damages clauses are concerned, English contract law recognises that, if the parties agree that a party in breach of contract shall pay an unjustifiable amount in the event of a breach of contract, their agreement is to that extent unenforceable . The reasons for this exception may be pragmatic rather principled.”

4. Arden LJ then cited the following comments of Diplock LJ in *Robophone Facilities v Blank* [1966] 1 WLR 1428 (at pages 1446 to 1447):

“I make no attempt, where so many others have failed, to rationalise this common law rule. It seems to be *sui generis*. The court has no general jurisdiction to re-form terms of a contract because it thinks them unduly onerous on one of the parties—otherwise we should not be so hard put to find tortuous constructions for exemption clauses, which are penalty clauses in reverse; we could simply refuse to enforce them. ... But however

⁴ See The Penal Bond with Conditional Defeasance AWB Simpson which demonstrates that English Law has not always decried all penalties in commercial contracts/instruments. Penal bonds were common until the mid-17th Century.

⁵ *Export Credits Gaurantee Department v Universal Oil Products* [1983] 2 Lloyd’s Rep 152, at 155.

⁶ *Murray v Leisureplay plc* [2005] EWCA Civ 963 at para. 29

anomalous it may be, the rule of public policy that the court will not enforce a "penalty clause" so as to permit a party to a contract to recover in an action a sum greater than the measure of damages to which he would be entitled at common law is well established, and in these days when so often one party cannot satisfy his contractual hunger *a la carte* but only at the *table d'hote* of a standard printed contract, it has certainly not outlived its usefulness." [emphasis added]

5. There are, unsurprisingly, many myths abound when one considers liquidated damages⁷. This Paper seeks to address *some* of those myths. Part A considers whether the "compensatory model" really is at play? Or is there another 'test' for the enforceability of liquidated damages that *really* determines the cases? Part B examines the issue that a sum of money payable otherwise than on a breach of contract cannot be a penalty (regardless of its size and variance to actual loss) and Part C considers whether liquidated damages are *always* "an exclusive remedy".

Summary

6. The "compensatory model" is, in practice, far too basic a 'test'. The case law⁸ indicates that a clause will not be struck down as a penalty where

⁷ As discussed above, the courts appear to take the view that liquidated damages serve the useful purpose of promoting commercial certainty and avoiding litigation. In *Clydebank Engineering & Shipbuilding Company Ltd v Yzquierdo y Casteneda* Lord Halsbury said:

It is obvious on the face of it that the very thing intended to be provided against by this actual amount of damages is to avoid that kind of minute and somewhat difficult and complex system of examination which would be necessary if you were to attempt to prove the damage.

In *Robophone Facilities Ltd v Blank*, Diplock LJ said:

It is good business sense that parties to a contract should know what will be the financial consequences to them of a breach on their part, for circumstances may arise when further performance of the contract may involve them in loss ... Not only does it enable the parties to know in advance what their position will be if a breach occurs and to avoid litigation at all, but, if litigation cannot be avoided, it eliminates what may be the very heavy legal costs of providing the loss actually sustained which would have to be paid by the unsuccessful party. The court should not be astute to descry a 'penalty clause' in every provision of a contract which stipulates a sum to be payable by one party to the other in the event of a breach by the former.

⁸ *Jeancharm Ltd v Barn at Football Club Ltd*, [2003] EWCA Civ 58 is an exceptional case. The Court of Appeal held that an interest rate of 5% per week for late payment was a penalty and therefore unenforceable. In particular their Lordships held that the decision in *Philips Hong Kong*

there is no oppression, and where the clause is commercially justifiable, provided always that its dominant purpose was not to deter the other party from breach. The courts appear not to be astute to descry a penalty clause and appear to be pre-disposed to uphold contractual terms fixing the level of damages for breach and that predisposition is even stronger in the case of commercial contracts freely entered into between the parties of comparable bargaining power.

7. Documents and agreements need to be reviewed very carefully. Sums that may *appear* to be liquidated damages may in fact not be so. English law provides that sum of money (or some other tangible benefit) which is payable otherwise than on a breach of contract cannot be a penalty. Agreements which are tangential to orthodox construction agreements (such as agreements for lease/development agreements) and which allow, for example, the payment of rent-free periods when there is a delay to completion of the demise do not fall foul of the rule of penalties (regardless of how steep the graduated rent-free 'payments' are).
8. It is submitted that where it is possible to recognize and distinguish any cost and expense that results from delay in completion of a project from any cost and expense which is referable to some other breach of contract (such failure to proceed regularly and diligently), these latter damages, even though *related* to the delaying event, may be recoverable notwithstanding the exhaustive nature of the liquidated damages provisions. Case law is available that supports this 'divisible' approach to

Ltd (see note 40) did not depart from the law as laid down in *Dunlop Pneumatic Tyre Company Ltd v New Garage & Motor Company Ltd* [1915] AC 79, and there was no abandonment of the rule that a clause should be a genuine pre-estimate of damage.

In *Jeancharm* the parties agreed that if Barnet were late in paying, they had to pay interest at 5% per week. If Jeancharm were late in delivering, they had to pay 20 pence per garment per day. Peter Gibson LJ set out four principles relevant for distinguishing a penalty clause from a valid contractual provision for payment.

the impact of breaches that can or do cause delay – especially when delay to completion has not occurred.

A. The “Test” for a Penalty

9. So what is the definitive “test” to be applied to assess whether a clause is a penalty? It is submitted that this can be distilled from a review of a number of ‘seminal’ cases.
10. For present purposes, a most useful *starting* point for the law on penalties is contained in “the classic statement ... by Lord Dunedin”⁹ in *Dunlop Pneumatic Tyre Company Limited v New Garage and Motor Company Limited* [1915] AC 79¹⁰. At pages 86 to 88, Lord Dunedin said this:

"1. Though the parties to a contract who use the word '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 penalty or liquidated damages. This doctrine may be said to be found *passim* in nearly every case.

"2. The essence of a penalty is a payment of money stipulated as in *terrorem* of the offending party; the essence of liquidated damages is a genuine covenanted pre-estimate of damage (**Clydebank Engineering and Shipbuilding Company v Don Jose Ramos Yzquierdo y Castaneda**).

"3. 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 as at the time of making the contract, not as at the time of the breach (**Public Works Commissioner v Hills** and **Webster v Bosanquet**).

⁹ per Arden LJ in *Murray* at para 34.

¹⁰ In that case, The clause in question was a standard form, imposed on all of Dunlop's customers, that required the payment of five pounds by way of "liquidated damages" if the customer did any one of the acts of tampering with marks on the goods; selling at under list price; supplying to persons blacklisted by Dunlop; or exporting without Dunlop's consent.

"4. To assist this task of construction various tests have been suggested, which if applicable to the case under consideration, may prove helpful, or even inclusive. Such are:

(a) 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. (Illustration given by Lord Halsbury in **Clydebank** case) ...

(c) There is a presumption (but no more) 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.' (Lord Watson in **Lord Elphinstone v Monkland Iron and Coal Company**)

"On the other hand:

"(d) 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. On the contrary, that is just the situation when it is probable that pre-estimate damage was the true bargain between the parties (**Clydebank** case, Lord Halsbury; **Webster v Bosanquet**, Lord Mersey)".

11. The second 'seminal' case is *McAlpine (Alfred) Capital Projects Ltd v Tilebox Ltd* [2005] EWHC 281 (TCC), (2005) 104 ConLR 39. In that case, Jackson J (as he then was) conducted a thorough judicial analysis of a number of authorities, distilled the same and formulated a set of 'rules' or propositions.
12. The learned judge looked at *Robophone Facilities Limited v Blank* [1966] 1 WLR 1428, where the Court of Appeal by a majority upheld a liquidated damages clause in a hiring contract. It is noteworthy that Jackson J highlighted that "the relevant clause in this case was subject to **closer arithmetical scrutiny** than appears to have been applied earlier cases, before a decision was reached that this was a reasonable pre-estimate of the loss. " [emphasis added]

13. Jackson J then adds "At the end of his judgment, at page 1449 Diplock LJ said this:

"I see no reason in **public policy** why the parties should not enter into so sensible an arrangement under which each know where they stand in the event of a breach by the defendant, and can avoid the heavy costs of proving the actual damage if litigation ensues. And I see no ground in authority which would permit, much less compel me to hold that this clause is a 'penalty clause' and so unenforceable by the courts ..." [emphasis added]

14. The Judge then considered the "widely used" *Philips v The Attorney General of Hong Kong* [1993] 61 BLR 41. Here the Privy Council upheld the decision of the Hong Kong Court of Appeal that the liquidated and ascertained damages clause in a construction contract was valid and enforceable. Emphasis was placed on the leading judgement of Lord Woolf MR who had stated:

"Except possibly in the case of situations where one of the parties to the contract is able to **dominate** the other as to the choice of the terms of a contract, it will normally be insufficient to establish that a provision is objectionably penal to identify situations where the application of the provision could result in a larger sum being recovered by the injured party than his actual loss. Even in such situations so long as the sum payable in the event of non-compliance with the contract is **not extravagant**, having regard to the range of losses that it could reasonably be anticipated it would have to cover at the time that the contract was made, it can still be a genuine pre-estimate of the loss that would be suffered and so a perfectly valid liquidated damage provision. The use in argument of unlikely illustrations should therefore not assist a party to defeat a provision as to liquidated damages. As the Law Commission stated in Working Paper No 61 (page 30):

"The fact that in certain circumstances a party to a contract might derive a benefit in excess of his loss does not ... outweigh the very **definite practical advantages of the present rule** upholding a genuine estimate, formed at the time the contract was made of the probable loss'.

"A difficulty can arise where the range of possible loss is broad. Where it should be obvious that, in relation to part of the range, the liquidated damages are **totally out of proportion to certain of the losses which may be incurred**, the failure to make special provision for those

losses may result in the 'liquidated damages' not being recoverable. (See the decision of Court of Appeal on **very special facts** in *Ariston SRL v Charly Records Limited* (1990) The Independent 13 April 1990.) However, the court has to be careful not to set too stringent a standard and bear in mind that what the parties have agreed should normally be upheld. Any other approach will lead to undesirable uncertainty, especially in commercial contracts." [emphasis added]

15. Having considered the above authorities Jackson J made four general observations. These observations or propositions are frequently cited in pleadings in domestic and international construction disputes. The observations are: [emphasis added]

"1. There seem to be two strands in the authorities. In some cases judges consider whether there is an **unconscionable** or **extravagant** disproportion between the damages stipulated in the contract and the true amount of damages likely to be suffered. In other cases the courts consider whether the level of damages stipulated was reasonable. Mr Darling submits, and I accept, that these two strands can be reconciled. In my view, a pre-estimate of damages does not have to be right in order to be reasonable. There must be a substantial discrepancy between the level of damages stipulated in the contract and the level of damages which is likely to be suffered before it can be said that the agreed pre-estimate is unreasonable.

2. Although many authorities use or echo the phrase "genuine pre-estimate", the test does not turn upon the genuineness or honesty of the party or parties who made the pre-estimate. The test is primarily an objective one, even though the court has some regard to the thought processes of the parties at the time of contracting.

3. Because the rule about penalties is an anomaly within the law of contract, the courts are predisposed, where possible, to uphold contractual terms which fix the level of damages for breach. This predisposition is even stronger in the case of commercial contracts freely entered into between parties of comparable bargaining power.

4. Looking at the bundle of authorities provided in this case, I note only four cases where the relevant clause has been struck down as a penalty. These are *Commissioner of Public Works v Hills* [1906] AC 368, *Bridge v Campbell Discount Co Limited* [1962] AC 600, *Workers Trust and Merchant Bank Limited v Dojap Investments Limited* [1993] AC 573, and *Ariston SRL v Charly Records* (Court of Appeal 13th March 1990). In each of these four cases there was, in fact, a very wide gulf between (a) the level of damages likely to be suffered, and (b) the level of damages stipulated in the contract.

16. Jackson J did not speak solely of a “compensatory model” or focus on the objective mismatch between the sums stated in the contract and the most likely damages recoverable for breach. Instead, Jackson J’s analysis and decision appears to be concerned more with:
- a. The Public Policy of enforcing clauses that fix the level of damages;
 - b. The Court’s predisposition to uphold such clauses;
 - c. The Practical advantages of upholding terms;
 - d. The Risk of uncertainty¹¹ if the above are not followed; and
 - e. The possibility of exploiting the fact there has been domination by one party when the contract was formed;
17. A more ‘intrusive’ approach was advocated in the next ‘seminal’ case of *Murray v Leisureplay plc* [2005] IRLR. Arden LJ suggested that the following “practical step by step guide as to questions which the court should ask” when considering the question of penalties:
- (i) To what breaches of contract does the contractual damages provision apply?
 - (ii) What amount is payable on breach under that clause in the parties’ agreement?

¹¹ There also appears to be a judicial desire to preserve freedom to contract. In *Elsley v JG Collins Insurance Agencies Ltd* Dickson J said:

It is now evident that the power to strike down a penalty clause is a blatant interference with freedom of contract and is designed for the sole purpose of providing relief against oppression for the party having to pay the stipulated sum. It has no place where there is no oppression.

Further, in *Philips Hong Kong Ltd v Attorney General of Hong Kong*, Lord Woolf said:

...the court has to be careful not to set too stringent a standard and bear in mind that what the parties have agreed should normally be upheld. Any other approach will lead to undesirable uncertainty especially in commercial contracts.

(iii) What amount would be payable if a claim for damages for breach of contract was brought under common law?

(iv) What were the parties' reasons for agreeing for the relevant clause?

(v) Has the party who seeks to establish that the clause is a penalty shown that the amount payable under the clause was imposed *in terrorem*, or that it does not constitute a genuine pre-estimate of loss for the purposes of the *Dunlop* case, and, if he has shown the latter, is there some other reason which justifies the discrepancy between i) and ii) above?

18. Arden LJ then considered the question of evidence available to the Tribunal:

"... What happens if there is no evidence about the reasons for the clause? There would in my judgment be no reason why the court could not draw inferences of fact as to the reasons and as to the genuineness of those reasons. What if it appears from the evidence that is given (or from the inferences that the court makes from the facts) that the decision to include the damages clause was included on the basis of a mistaken belief that the damages at common law would be assessed on a materially more generous basis than in fact would occur? This would be the case if for example the parties failed to have regard to the fact that a party would have to give credit for a benefit that he obtained on breach, such as a tax saving as a result of the receipt of damages for lost income in the form of a lump sum payment of damages. In my judgment, the good faith belief of the parties is not the deciding factor here. The court would look at the result and (bearing in mind that the onus is on the party challenging the clause to establish that it is a penalty) ask whether it is satisfied that the parties could not, if they had had the proper information or considerations in front of them, genuinely have considered that the damages payable under the contractual provision were a realistic pre-estimate of the damages payable on breach at common law. [emphasis added]

19. Arden LJ appears to be advocating an intrusive approach whereby the Court, in effect, tests the genuineness of the pre-estimate and is rather less concerned with the public policy reasons for upholding penalty clauses.

20. *Murray* is not a construction case but was concerned with whether a clause in a director's service agreement providing for payment of a year's gross salary in the event of termination of the director's employment

without one year's notice was unenforceable as a penalty. In many cases Murray will be a useful guide¹². It is noteworthy that this 'test' has not been discarded as simply inapplicable for use in construction contracts although Sir Kim Lewison states that in some cases a broader approach will be necessary.

21. Indeed "broader approaches" were advocated by Clarke LJ and Buxton LJ. Clarke LJ's 'test' can be summarised as: [emphasis added]

a. Given the general principle that *pacta sunt servanda*, the courts should be cautious before holding that a clause in a contract of this kind is a penalty.

ii) The modern approach to Lord Dunedin's test in *Dunlop Pneumatic Tyre v New Garage and Motor Company Ltd* [1915] AC 67 at 86 is to be found in *Lordsvale Finance plc v Bank of Zambia* [1996] QB 752 per Colman J at page 762G and *Cine Bes Filmcilik Ve Yapim Click v United International Pictures* [2003] EWCA Civ 1699.

iii) It is perhaps no longer entirely appropriate to ask whether a payment on breach was stipulated *in terrorem* of the offending party but, as Colman J put it in the *Lordsvale* case at page 762G (in a passage quoted by both Arden and Buxton LJ):

"whether a provision is to be treated as a penalty is a matter of construction to be resolved by asking whether at the time 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."

iv) Colman J continued:

"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 the breach occurred."

I do not read Colman J as saying there that, if that comparison discloses a discrepancy, it follows that the clause is a penalty. It seems to me that the comparison is relevant but no more than a guide to the answer to the question

¹² *The Interpretation of Contracts* Sir Kim Lewison Sweet & Maxwell 2007 ISBN 9781847033550 pp 594.

whether the clause is penal: see e.g. *Philips Hong Kong v A-G of Hong Kong* (1993) 61 BLR 49 per Lord Woolf at 58-9.

v) In paragraph 15 of his judgment in the *Cine* case (set out by Arden LJ at paragraph 39) Mance LJ quoted a further passage from the judgment of Colman J in the *Lordsvale* case (at pages 763g-764a) where he said that a particular clause might be commercially justifiable, provided that its dominant purpose was not to deter the other party from breach.

vi) As I see it, each case depends upon its circumstances and, in considering those circumstances, the court should have in mind the warnings to which Arden and Buxton LJ have adverted. They include the importance to the parties both of knowing what will be the financial consequences to them of a breach of contract (*Robophone v Faciilites v Blank* [1966] 1 WLR 1428 per Diplock LJ at 1447) and of avoiding disputes (*Kemble v Farren* (1829 6 Bing 141 per Tindal CJ at 148). They also include the statements to the effect that a clause will only be held to be a penalty if the sum payable on breach is extravagant or unconscionable: see eg the *Philips Hong Kong* case per Lord Woolf at page 59 and *Dunlop* per Lord Dunedin at page 87.

vii) ...

xi) It is in my opinion important to avoid nice calculations but to look at the question in the round. It was not for Mr Murray to justify the clause but for the respondent to show that it was a penalty. It adduced no or no sufficient evidence that the clause was unconscionable..."

22. The strongest support for the 'older approach' less intrusive approach came from Buxton LJ: [emphasis added]

I venture to disagree with that approach [of Arden LJ] because it introduces a rigid and inflexible element into what should be a **broad and general question**. It is also inconsistent with warnings by judges of high authority that, at least in connexion with commercial contracts, great caution should be exercised before striking down a clause as penal; and with the tests that they have postulated to that end. My Lady has cited in her paragraph 66 the observations of Diplock LJ in *Robophone v Blank* [1966] 1 WLR 1428 at p 1447. I would add the well-known passage of Lord Woolf in *Philips Hong Kong v A-G of Hong Kong* (1993) 61 BLR 49 at pp 58-59:

"Except possibly in the case of situations where one of the parties to the contract is able to dominate the other as to the choice of the terms of a contract, it will normally be insufficient to establish that a provision is objectionably penal to identify situations where the

application of the provision could result in a larger sum being recovered by the injured party than his actual loss. Even in such situations so long as the sum payable in the event of non-compliance with the contract is not extravagant, having regard to the range of losses that it could reasonably be anticipated it would have to cover at the time the contract was made, it can still be a genuine pre-estimate of the loss that would be suffered and so a perfectly valid liquidated damages provision"

And exclusive concentration on the factual difference between the liquidated and the contractual damages overlooks a principal test formulated by Lord Dunedin to identify a penalty, [1915] AC at p 87, that

"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"

Dunlop differed from the present case in that the House was impressed by the difficulty of proving an exact loss in every, or any, of the many cases of breach to which the clause extended. That particular problem does not affect our case. But the cautious approach of the House, and its willingness to look at the clause in its commercial context, does at least underline the importance stressed by Lord Woolf of not moving automatically from the fact that a clause could result in greater recovery than the amount of the actual loss to an assumption that without further justification the clause must be penal in nature."

23. The final and most recent seminal case is *Steria Limited v Sigma Wireless Communications Limited* (2007) EWHC 3454. In that case HHJ Stephen Davies considered the above mentioned cases and sought to avoid the use of any sort of binary test preferring instead to state that "The question is a broad and general question, and that in commercial contracts the courts should exercise great caution before striking down a clause as penal"¹³. [emphasis added].

Conclusions

24. The Arden LJ approach is the most intrusive approach and is likely to receive much adjudication, arbitral and judicial scrutiny. However, it is difficult to see how the 'test' established by Lord Dunedin in *Dunlop* has been fundamentally departed from. It is submitted that that test was that liquidated damages clauses were a genuine pre-estimate of loss whereas a penalty clause was inserted to deter the other party from breaching the contract.
25. The real issues in the case-law since *Dunlop* have been:
- a. whether one needs to focus on the genuineness of the pre-estimate of loss or on whether the dominant purpose of the sum inserted was to act as a deterrent; or if this 'test' is simply 'trumped' by
 - b. public policy that there is a very strong predisposition to uphold contractual terms fixing the level of damages for breach in cases of commercial contracts freely entered into between parties of comparable bargaining power.
26. Whilst, some judicial comments are 'attractive' for those seeking to argue penalty it is highly tempting to believe that the public policy or "commercially justifiable" reasons will always prevail. This is especially so because the Courts do not wish to take a detailed analysis (akin to that advocated by Arden LJ) of the "compensatory model".
27. Those seeking to argue that a sum is a penalty *can* take encouragement from Coleman J in *Lordsvale Finance v Bank of Zambia* [1996] QB 752 approved by Mance LJ in *Cine*
- ""whether a provision is to be treated as a penalty is a matter of construction to be resolved by asking whether at the time the

¹³ See Para 100 of *Steria*

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 the 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 the breach occurred."

28. However, Buxton LJ says that there are two alternatives a deterrent penalty or a genuine pre-estimate of loss with no middle ground but that it will be a genuine pre-estimate of loss "if the court cannot say with some confidence that the clause is indeed intended as a deterrent". This approach supports the concept of a presumption of 'enforceability'.
29. In conclusion, it appears that a 'good arguable challenge' to a specified sum stated to be a liquidated damages will be where:
 - a. The Payor can prove on the balance of probabilities that the stated sum had the dominant purpose of acting as a deterrent; *and*
 - b. The Payor can prove on the balance of probabilities that the sum was not a genuine pre-estimate of loss because there was a substantial discrepancy between the stated sum and the actual claim for damages.
30. In all other cases, the risk of public policy of upholding contracts freely entered into by parties of comparable bargaining power (ie little avenue to argue oppression¹⁴) means that the stated sums *will be* or are highly likely to be enforceable.¹⁵

¹⁴ Tomlinson J in *Indian Airlines Ltd v GIA International Ltd* said:

...to strike down this agreement made between two substantial parties...would indeed be a blatant interference with freedom of contract, and, bearing in mind that the doctrine is intended to provide relief against oppression, I cannot believe that there is any room for the application of the doctrine here, where there may have been hard bargaining but, in my judgment, nothing which comes *even close to oppression*. [emphasis added]

B. Sum must be payable on Breach of Contract¹⁶

31. In many construction related agreements, for example in project finance agreements and property development agreements, clauses often give one party to the contract an option of terminating on the payment of an additional sum or make express provision for the payment of a specified sum on the occurrence of a specified event (where that event does not involve a breach of contract by the payer).¹⁷
32. For example, in property development it is usual for an agreement for a lease (between the property developer and prospective purchaser/tenant) to provide that if a certain specified event occurs then specified sums or rent-free periods are payable by the developer to the prospective purchaser/tenant. A typical clause might read:

In *Indian Airlines* (where Indian Airlines sought summary judgment for the sum of \$5,550,000 as liquidated damages) it was accepted that Indian Airlines had not given any indication that they considered the daily liquidated damages figure inserted in the contract represented a genuine estimate of possible loss. Evidence was also admitted to the court that an Indian Airlines' representative had said that the penalty provision had to be \$8,500 and that if GIA did not agree to that sum discussions would be over and GIA would no longer have the deal. Counsel for GIA also argued that the sum stipulated had not been estimated, reflected twice the daily rental figure and was simply intended to put pressure on GIA to perform. GIA also argued that the sum was oppressive because it did not diminish over time and it was open to Indian Airlines to continue to hold GIA to its contract and decline to exercise the right to terminate but continue to recover the stipulated liquidated damages.

¹⁵ Following delivery of this Paper the decision in *Liberty Mercian Ltd v Dean & Dyball Construction Ltd* [2008] EWHC 2617 (TCC) was handed down by Coulson J. The judge made it clear that that the "courts have always been wary of allowing one party to a contract to avoid the consequences of a liquidated damages provision freely entered into" and that a "mathematical" approach to liquidated damages should not be advocated. The Court considered cases where drafting of liquidated damages clauses were unenforceable due to uncertainty and where the contractual machinery itself prevented the proper operation of such clauses. However, the Judge held that the contract in this case construed as a whole was enforceable and contained no penalties.

¹⁶ It should be noted that a clause may amount to a penalty even if it requires no payment, if, it requires a transfer of property (or shares) on breach of an obligation as evidenced in *Jobson v Johnson* [1989] 1WLR 1026 CA.

¹⁷ Such clauses are not common in 'pure' construction contracts because there is usually an express contractual obligation on the contractor to reach practical completion by a specified date. It should also be noted that Agreements for Lease do not typically have provisions for pure liquidated damages for delayed completion or provide for any extensions of time. Instead such

If the Developer's Works have not achieved Practical Completion by [a specified date] the rent commencement date shall be postponed by two days for every day that Practical Completion is delayed.

33. In some agreements, the sum payable or the rent-free period may increase with each specified event. For example a typical clause might read:

If —

- (i) the Date of Practical Completion has not occurred by the [First Target Date] the rent commencement date shall be postponed by two days for every day that Practical Completion is delayed from the [First Target Date] to the Date of Practical Completion and
- (ii) the Date of Practical Completion has not occurred by the [Second Target Date] the rent commencement date shall be postponed by three days for every day that Practical Completion is delayed from the [Second Target Date] to the Date of Practical Completion and
- (iii) the Date of Practical Completion has not occurred by the [Third Target Date] the rent commencement date shall be postponed by four days for every day that Practical Completion is delayed from the [Third Target Date] to the Date of Practical Completion.

34. A developer, especially in the latter example, may be tempted to argue that the provision of the rent-free periods is an unenforceable penalty and does not represent a genuine pre-estimate of the prospective tenant's loss. The Target Dates *may* be only days apart and the developer may assert that graduating the payment of rent-free days at such a steep incline is simply penal. He may also argue that it is absurd that he is required to pay penal sums on the occurrence of an event whilst if he had breached a contractual obligation the doctrine of penalties would apply. It is also possible that a developer may argue that the principle should not apply to events for which he has been allocated the risk and that can *only* arise due to his default - even though the default may not be a breach of an express contractual term.

(non-construction) agreements provide long-stop dates after which termination of the relevant agreement is the 'remedy'.

35. There does not appear to be a case directly on the points discussed above. But who is correct? Is the developer correct in asserting that the specified events which (in practice) can *only* arise because of a default (although there is no contractual obligation upon him to prevent the events) are sufficient so that the doctrine of penalties would apply? Would the tenant be correct in asserting that the freely agreed contract terms should be upheld and even if the sums payable *appear* to be penal, the fact that payment is triggered by the occurrence of an event (as opposed to a breach of a contractual obligation) means that the doctrine of penalties simply does not apply? In short, in the tenant's view, the parties' freedom to contract should be upheld by the Courts.
36. The correctness of the view that the doctrine of penalties has no application to a clause which provides for the payment of an agreed sum on the happening of a specified event other than a breach of contract has been affirmed by the House of Lords in *Export Credits Guarantee Department Ltd v Universal Oil Products Company & Procon Inc.*¹⁸
37. The House of Lords in *Export Credits* held that a clause which provided for payment of money on the happening of a specified event other than a breach of contractual duty owed by the contemplated payer to the contemplated payee was not a penalty. In that case, A agreed to build a refinery. Finance was provided by B and guaranteed by C. A and C entered into an agreement under which A undertook to reimburse C for any payments made by C to B. A defaulted under the finance agreement with B, and consequently C's guarantee was called upon. When C sought reimbursement from A, A alleged that the agreement was a penalty. The House of Lords disagreed and decided that the sum of £39,571,001.54 payable by A was not a penalty because the clause provided for payment

¹⁸ *Export Credits Guarantee Department v Universal Oil Products Company & Procon Inc* [1983] WLR 399 (also [1983] 2 All ER 205, 23 BLR 106), HL.

of money upon the happening of a specified event rather than a breach of contract

38. Lord Roskill considered that their Lordships had 'finally and authoritatively determined' the question of whether the doctrine of penalties applied to payments due on the occurrence of a specified event. It is noteworthy that Lord Roskill's judgment was based on an *unreported* case. He said:

... I have arrived at this conclusion in complete agreement with the Courts below and for the same reasons... But both courts below relied upon a virtually unreported decision of the Court of Appeal in *Philip Bernstein (Successors) Ltd v Lydiate Textiles Ltd* (1962)...

39. In *Philip Bernstein*¹⁹ dealers had agreed with a finance company for commission to procure offers from hirers to enter into hire purchase agreements with the finance company. They also agreed that if the hirers defaulted under the agreements they would pay the finance company an amount equal to any unreceived payments of hire due under the agreements. Diplock LJ said there was no question of any breach of contractual obligations, but the defendants were sued in respect of sums payable upon a 'specified eventuality'. He said it had been conceded that there was no case in which it had been held that a payment to be made in a specified eventuality was a penalty, but he was not prepared to extend the definition of 'penalty.'
40. There are other cases that uphold the principle. In *Alder v Moore*²⁰ the defendant professional footballer was insured against disablement. He was injured and received a payment from the insurers. Under the terms of the policy no claim was to be paid unless Moore signed a declaration to the effect that he would not play professional football in the future, and that in the event of infringement he would forfeit the monies paid. Moore signed a declaration saying:

¹⁹ *Philip Bernstein (Successors) Ltd v Lydiate Textiles Ltd unreported, 26th June 1962, CA.*

²⁰ *Alder v Moore* [1961] 2 QB 57.

In consideration of the above payment I hereby declare and agree that I will take no part as a playing member of any form of professional football in the future and that in the event of infringement of this condition I will be subject to a penalty of the amount stated above [£500].

41. The Court of Appeal (Devlin LJ dissenting) held that no contractual obligation was created by the words 'I agree' and consequently the sum payable was simply payable on the happening of an event not involving a breach of contract and so was not capable of being a penalty.
42. In another relevant case, *Jervis v Harris*²¹ a lease contained a clause which entitled the landlord to enter the property and carry out repairs, which the tenant ought to have carried out in accordance with the covenants in the lease, and then recover the cost of the repairs from the tenant. The Court of Appeal held that the nature of the sums recoverable by the landlord was a debt, and hence it was not a penalty. Millet LJ stated:

The landlord's claim sounds in debt not damages; and it is not a claim to compensation for a breach of the tenant's covenants to repair... The law of contract draws a clear distinction between a claim for payment of a debt and a claim for damages of breach of contract...a debt is a definite sum of money fixed by the agreement of the parties as payable by one party...on the occurrence of some specified event...²²

He concluded that:

But 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.²³

²¹ *Jervis v Harris* [1996] Ch 195, CA. Interestingly this case overruled *Swallow Securities Limited v Brand* (1981) 260 EG 63 and in practice *Jervis* introduced certainty into the law and appeared to be welcomed by landlords who were subsequently more willing to use the self-help remedy ordinarily available in such leases.

²² See note 21, at page 202.

²³ See note 21, page 206.

He also reinforced the approaches of Lord Roskill in *Export Credits* and Lord Diplock in *Philip Bernstein* in not extending the law by giving relief against penalties, stating that the approach taken by their Lordships has:

...all the more force in a case...where the court is asked for the first time to strike down a standard clause which has been familiar to property lawyers for generations, which has been enforced on countless occasions...²⁴

Conclusions

43. From a review of the above cases it would appear unlikely that a court of first instance would be prepared to overrule Diplock LJ (as he then was), Lord Roskill and Millet LJ (as he then was) and extend the doctrine of penalties to sums payable on the occurrence of specified events other than on a breach of a contractual obligation.

44. In summary it is clear that a sum of money (or other tangible benefit) payable otherwise than on a breach of contract cannot be a penalty. This issue has 'forced' many to inspect closely documents which provide for pre-agreed 'damages' (or more properly defined, 'sums of money') but where a breach of contract is not readily visible. Indeed, on the subject of development agreements/agreements for lease which ordinarily contain 'event based' rent-free period provisions, there is now an increasing tendency to have liquidated damages linked to the developer's obligation to complete the lease by a certain specified date. This does, of course, not preclude the use of a long-stop date that would allow termination of the agreement for lease.

²⁴ See note 21, at pages 206-7.

C. LADs as an Exclusive Remedy

45. Imagine the following scenario:

The EPC Contractor has threatened to “go slow” with construction work in respect of the Ethylene Facilities. A question arises about what immediate remedies (that is, before Completion) may be available to the Client under the EPC Contract. The Group Counsel wants to know:

- (a) Do the delay damages provisions under the contract (the **Delay Damages Provisions**) prevent the Client from enforcing any rights for breach of these work performance obligations? In other words, are the delay damages an exhaustive remedy?
- (b) If the answer to (a) is “no”, does the breach of a due diligence clause by the Contractor allow the Client to claim damages/injunctive relief notwithstanding the Delay Damages Provisions?
- (c) What does performing work “diligently” mean?

46. In general, the nature and effect of a liquidated damages clause depends on its construction. It has been suggested by commentators²⁵ that in building contracts a clause providing for payment by the contractor of liquidated damages for delay will normally operate as a limitation of the contractor’s liability. This is based on the Court of Appeal decision in *Temloc Ltd v Errol Properties Ltd (1987) 39 Building Law Reports*²⁶ where Nourse LJ expressed the view that it was “clear, both as a matter of construction and as one of common sense, that [the particular liquidation clause in *Temloc*] constitutes an exhaustive agreement as to the damages which are, or are not, to be payable by the contractor in the event of his failure to complete the works on time”.

²⁵ Keating on Building Contracts, Sweet & Maxwell, 2006, paras. 9-06

²⁶ By Clause 24.2.1 of the 1980 RIBA/JCT form of contract, the owner, upon a certificate of failure to complete under Clause 24.1, was entitled to “a sum calculated at the rate stated in the Appendix” as liquidated damages from that date to practical completion. The “rate” under Clause 24.2 was inserted in the Appendix as “£nil”, and the period for the payment was left blank. The owner claimed that the word meant that he was entitled to damages at large for delay in

47. It should be noted, that there *is* doubt as to whether *Temloc* should indeed be treated as definitive authority where similar wording is used. The case seems extreme on its facts and conclusions. According to Hudson, the wording at best "seems ambiguous, given the position of parties faced with a complicated standard form and desiring merely to avoid a fixed liability in all situations"²⁷. This doubt, however, is not strong.
48. More recently two decisions (of the Ramsey J) have added further weight to this. In *Chattan Developments Ltd v Reigill Civil Engineering Contractors Ltd* [2007] EWHC 305 in, an appeal pursuant to Section 69 of the Arbitration Act, construed an oral agreement and concluded (a para. 31) that:

"when there is a valid and enforceable liquidated and ascertained damages clause within an agreement, those damages are the sole remedy for the particular breach to which they relate, commonly delay in completion. Unliquidated damages are not recoverable because the parties' agreement of liquidated damages replaces the remedy which would otherwise be available for breach. As can be seen from *Temloc*, the question of whether unliquidated damages could be recovered was a matter of the interpretation of the agreement from which it was possible to find a clear intention to exclude that remedy. In the case of a written agreement, that clear intention can be usually derived by construing the terms of the written agreement as a whole. For example, it was not necessary in *Temloc* for there to be an express exclusion clause to preclude the remedy of unliquidated damages."

49. However, it ought to be noted that Ramsey J based his Decision on the interpretation of an oral agreement and on witness evidence²⁸. Counsel in that case had argued that a written agreement was at play and that a

completion, from either the contract date or reasonable date. The Court of Appeal held that the insertion of "£nil" in the Appendix was an exemption from all delay in completion.

²⁷ Hudson's Building and Engineering Contracts, Sweet & Maxwell, 1995 paras. 10.023

²⁸ See Para 28 where Ramsey J states "It is clear that the agreement which was formed in this case was made orally at the meeting on 10 July 2002 and that whilst the letter of 11 July 2002 might be evidence the terms of that agreement, it does not stand as a written agreement. In this case, the parties did not subsequently enter into a written agreement or produce a copy of the JCT Standard Form to which they worked"

right to unliquidated damages under clause 23 of the JCT form existed because of Lord Diplock's decision in *Gilbert-Ash (Northern) Ltd v Modern Engineering (Bristol) Ltd* [1974] AC 689:

"But in construing such a contract one starts with the presumption that neither party intends to abandon any remedies for its breach arising by operation of law, and clear express words must be used in order to rebut this presumption."

50. Counsel appeared to be fortified because the Arbitrator appeared to accept that position too:

"Mr Edwards points out that in Reigill's letter of 11 July 2002 to Chattan no mention is made of unliquidated damages. I would concur that the position could have been put beyond argument if that letter had expressly stated that unliquidated were also excluded. However, I do not accept that because no statement to that effect was included, it is fatal to Reigill's case. As has been argued for Reigill, the letter was intended to record the terms of the Contract but that is not the contract itself. I would also observe the fact of there being no mention in the letter of 11 July 2002 of unliquidated damages is consistent with Mr Bossom's evidence about his view of it being necessary in the circumstances of this case to write them in."

51. However, Ramsey J appears to have 'cut-off' this line of challenge stating "... in the case of a written agreement, that clear intention [to exclude the un-liquidated damages remedy] can usually be derived by construing the terms of the written agreement as a whole".

52. In the second case dealing with this issue, *Biffa Waste Services Limited v Maschinenfabrik* [2008] EWHC 6, Biffa sought to argue that a valid and enforceable liquidated damages clause was an exclusive remedy for breach only of the obligation to complete on time. It was argued that it was not applicable to breach of other obligations (which whilst causing delay) were not obligation dealing with a failure to complete on time. It was argued that such breaches allow an entitlement to un-liquidated damages. Ramsey J held that:

"...the general position [is] that a liquidated damages clause in a contract covers "all the damages for non-completion" or "constitutes an exhaustive agreement as to the damages which are or are not to be payable by the contractor in the event to the failure to complete the works on time": see Temloc Ltd v. Errill Properties Ltd (1987) 33 BLR 30 at 38 to 40

53. Ramsey J cited support from HHJ Gilliland QC in *Piggot Foundations Ltd v Shepherd Construction Ltd* [1993] 67 BLR 48 and HHJ Fox-Andrews QC in *Surrey Heath Borough Council v Lovell Construction Ltd* (1988) 42 BLR 25²⁹.
54. The irresistible conclusion is that a valid enforceable liquidated delay damages clause presents an exclusive or exhaustive remedy for delay regardless of what breach of whatever obligation has caused (partly or wholly) the delay. This is 'complete remedy' analysis is summarized in Keating on Construction Contracts³⁰:

"It is suggested that the solution is primarily a question of the construction of the contract in question. If, as in most (if not all) cases, the clause is clearly expressed to be or, as a matter of proper construction appears to be, a complete remedy for delayed completion then it matters not why the contractor failed to complete by the due date...The fact that the delay is due to a breach of contract by the contractor as opposed to merely going slow, cannot affect the nature or quality of the loss which the liquidated damages is intended to compensate. In reality, in such situations, there are two breaches: the carrying out of the defective work...and the failure to complete by the due date. Neither the employer nor the contractor can avoid liquidated damages by simply relying on the first breach."

55. This would tend to the view that the Client in the above scenario has no remedy (damages or injunctive) for the failure to proceed diligently. This is because that 'all obligations that bite on delay' are covered by the liquidated damages clause.

²⁹ In the former case HHJ Gilliland QC held that a valid enforceable liquidated damages clause "prevents the defendant from seeking to avoid the overall limitation of damages to £40,000 by claiming as a head of general damages for the breach of any other provisions or obligation under the contract such damages which have resulted from the failure of the plaintiff to complete the piling work within the period of 10 weeks." and in the latter the learned Judge found that the liquidated damages clause was an exhaustive remedy for delay where a building had been damaged by fire.

Similar reasoning was used by HHJ Coulson QC (as he then was) in *Decoma UK Ltd v Haden Drysys International Ltd* [2005] EWHC 2948 who stated that liquidated damages were an exclusive remedy for all claims arising out of Decoma's inability to use, and make profit out of, the paint spraying system due to Haden's delay in completing it to the required standard"

³⁰ Keating on Construction Contracts (8th Edition) at Para 9-006.

56. But can obligations that *may* but have not yet caused delay to completion – i.e. failure to proceed with diligence be also covered by the exclusive remedy of liquidated damages?
57. It is not beyond doubt that injunctive relief/damages are not recoverable in such circumstances. It follows that un-liquidated damages will only be permissible if the obligations (that are breached) are un-related to delay to completion? This was a small point addressed by HHJ Coulson QC (as he then was) in *Decoma UK Ltd v Haden Drysys International Ltd* [2005] EWHC 2948:

“... in addition to claims for liquidated damages for delay, Articles 3.1 and 3.2 were available to Decoma to found claims, if any, for non-delay breaches of contract...”

58. The emphasis therefore appears to be on breaches that do cause delay to completion. But how does this analysis sit with the Scottish case of *Scottish Coal Company v Kier Construction Ltd* [2005] CSOH. In that case Lady Smith was asked to consider a contract that provided liquidated damages both for³¹:

- i. Failure to complete extraction of all coal by the completion date; and

³¹ The exact clauses were:

" 7.9.1 In the event that the Contractor shall fail to execute and complete the Works by the Completion Date or such extended period as may be determined under Clause 5 the Employer may deduct from any payment or payments due or falling due to the Contractor under Clause 6 as liquidated damages and not as a penalty a sum of £5,000 per day for every day which shall elapse between after the Completion Date or such extended period as may be determined under Clause 5 and the date on which the Works are completed to the satisfaction of the Site Manager.

7.9.2 In addition and notwithstanding the provisions of Clause 7.9.1 if the Contractor fails to produce the minimum cumulative Gj's of Coal specified in Schedule Part 9 for any three consecutive Accounting Periods the Employer may deduct from payment any payment or payments falling due to the Contractor under Clause 6 a sum by way of liquidated damages and not as a penalty calculated by multiplying the difference between the cumulative Gj of Coal produced and the minimum cumulative Gj specified in Schedule Part 9 for the last of such Accounting Period by 0.04p per Gj. The Employer may deduct such damages on each and every occasion when default occurs."

ii. Failure to meet periodic minimum productivity targets (in terms of Gigajoules)

59. The contract as construed contained an obligation that all of the coal would be extracted. The contractor was in breach but argued (in the last resort) that the liquidated damages clause was applicable and that the employer had no right to unliquidated damages for failure to extract all of the coal. A deeper analysis requires us to consider whether the Contractor's failure to extract all of the coal did not lead to delay in completion? Further, does that obligation not have a direct link to delay to Completion? It is submitted that there does appear to be a direct link - But the Court held that the Contract contained an obligation to complete all extraction by a certain date (1 March 2003); But, did not contain a liquidated damage clause for that breach; which meant; The Employer could recover un-liquidated damages for failure to extract all the coal.
60. The Judge here was keen to take a 'divisible' approach to obligations and liquidated damages:

"I turn then to the central issue between the parties, namely that of whether or not the pursuers are only entitled to claim liquidated damages. The key to resolving this issue lies in, firstly, identifying the event in respect of which the pursuers claim that they are entitled to recover damages and, secondly, the event or events for which the contract makes provision by way of agreement to liquidated damages. To adopt the approach of Lord Wilberforce in *Suisse Atlantique Societe* at p.435: "First it is necessary to decide what is the legal nature of the ...clause : is it a clause by which damages for breach of contract are agreed in advance?". Following that approach involves determining what breach or breaches are covered by the clause, the problem for the plaintiffs in *Suisse Atlantique Societe* having been that the breach founded on was, on a proper analysis, a failure which was covered by the demurrage clause in the charterparty.

Lady Smith continued:

"I am, in particular, satisfied that it is not a matter of the pursuers' complaint being that completion was delayed to a date beyond the completion date in March 2003 nor is it a matter of the complaint being that they were late in meeting the targets set out in the delivery schedule although that is something which, no doubt, may also have arisen. The pursuers' complaint is a separate and fundamental one namely that the defenders did not complete the contract by fulfilling their obligation to extract all coal other than any that they were instructed by the site manager not to extract.

Conclusions

61. Does the above mean that a complaint about the failure to proceed diligently is a 'fundamental one and separate' to delay? It is submitted that where it is possible to recognise and distinguish any cost and expense that results from delay in completion of a project from any cost and expense which is referable to some other breach, these latter damages, even though they could be related to the delaying event, may be recoverable notwithstanding the exhaustive nature of the liquidated damages provisions. This is supported by the *obiter* of Nourse LJ in *Temloc* where he expressed the view that the damages payable in respect of completion of the works "are one head of general damages which may be recoverable by an employer for the contractors' breach of a building contract." The Building Law Reports commentary on *Temloc* suggests that this statement means that the employer might still be able to recover as unliquidated damages "losses attributable to causes which are independent of but related to the failure to complete"³².
62. Indeed, there has also been a view expressed by a leading commentator³³ that a party *can* claim damages for *pre-completion losses* (even if the claim is time-related) where the contractor breaches its ongoing duties under the contract, notwithstanding the *Temloc* case and the existence of a liquidated damages clause for delay. According to Hudson, express liquidated damages clauses for delay in completion are targeted at one narrow aspect of the damage which the owner may incur — namely damage resulting exclusively from delay in completion. In other words,

³² *Surrey Heath Borough Council v Lovell Construction Limited* (1988) 48 BLR 26 appears to be a case which supports this view. In that case, the judge found that whilst the liquidated damages clause in question exhaustively covered pure delay costs, the council was nevertheless entitled to recover other losses which were not related to delay costs (e.g. damage to certain items of property already installed in the new building and not covered by the contractual insurance, and extra professional costs incurred in the rebuilding work, provided they too were not covered by the contractual insurance, were not due to late completion and were not therefore recoverable).

³³ Hudson in *Hudson's Building and Engineering Contracts*, Volume 2, para. 9.032, Sweet & Maxwell, 1997

liquidated damages clauses are aimed only at damage which results from a delayed resumption of possession by the owner.

63. In Hudson's view, earlier "intermediate" delays by the contractor may cause immediate and serious damage to the owner which is not covered by the liquidated damages clause. This will usually take the form of liabilities of the owner to third parties, such as other contractors or sub-contractors, or to adjoining owners or public utilities, with whose requirements the work may have had to be coordinated by the owner or his advisers, and with whom commitments may have had to be undertaken. In Hudson's view, such immediate damages fall outside the liquidated damages clause and are claimable immediately. Hudson cites the cases³⁴ to support his view that damages resulting from earlier delays do not fall within the liquidated damages clauses.
64. When construing liquidated damages clause, there is also the possibility of drawing a distinction between delay and "disruption related costs"³⁵. The concept of delay is time related whereas the concept of disruption is organization/productivity related. In relation to the latter, it signifies that the progress of the works has become disorganized and inefficient. Whilst related to delay the existence of disruption is not dependent on time or delay. Indeed commenters suggest³⁶ that if one is able to distinguish and dissect those losses due to disruption from those related to delay, it is possible and logical to construct a case for the recovery of such losses in addition to liquidated damages for the delay. However, caution is advocated primarily because such a result would be rare in cases where the claims for delay and disruption are intertwined and not separately readily distinguishable.

³⁴ *AKT Reidar v Arcos Ltd (1927) 1 KB. 352; Chanthall Investments Ltd. v F. G. Minter Ltd (1976) S.C. 73; Turner & Sons Ltd. v Mathind (1986) 5 Const L.J 273.*

³⁵ This argument was used in *Pillar PG Limited v D J Hogans Construction Limited (1986) 10 Con LR 46*. The judgment of the Court of Appeal was short and its reasoning unclear. On the facts, it held that such a construction was not possible.

65. Further, Hudson takes the view that where there is an express liquidated damages clause as well as an express "due diligence" term, or where there are express intermediate completion dates stipulated in the contract which the contractor has failed to meet, intermediate delays by the contractors prior to completion will "of course" be a breach of contract for which such damages of the owner will be recoverable³⁷. Hudson cites the case of *Greater London Council v Cleveland Bridge and Engineering Company Ltd (1986) 34 BLR 50* to support this. Although the contractor met all key dates, the owners argued that the contractors had unnecessarily prolonged certain later and minor processes at the end of the manufacturing period so as to increase production cost. There was a liquidated damages clause, but only for late completion of the whole of the works and not for the intermediate key dates. There was no express due diligence clause. The issue arose before the court as to whether a due diligence obligation should be implied into the contract. Although both the first instance court and the Court of Appeal concluded that it was not possible to imply a due diligence clause in the form suggested by the owners on grounds that it was "abstract" and not related to the "objective"³⁸, they appeared to accept that the claim would have succeeded if there was an express due diligence clause. Staughton J expressly said that "if there had been a term as to due diligence I consider that it would have been, when spelt out in full, an obligation on the contractors to execute the work with such diligence and expedition as was reasonably required in order to meet the key dates".

Hamish Lal
14 December 2008

³⁶ *The ascertainment of damages for delay in construction contracts: liquidated and unliquidated damages*, Jonathan Hosie (1994) 10 Const LJ 214, August 1994, pg 25

³⁷ Note 33 para. 9.033

³⁸ per Parker LJ, pp 76-78. Both Staughton J and Parker LJ held that a term for due diligence cannot be defined except in terms of any contractual or extended dates for completion.