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Liquidated Damages

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RICS Seminar

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What we will cover?

1. An outline of liquidated damages (LDs)
2. Penalties doctrine
 - i. Scope
 - ii. Old test
 - iii. New test
3. Relevant case law authorities
4. Practical guidance
5. Grounds for challenging LD claims
6. Claims procedure (general)
7. Conclusion

Outline of Liquidated Damages

Introduction

- What are damages?
- Compensation
- What are Liquidated Damages?
 - Important feature of most construction contracts
 - Exclusive remedy
 - Pre-determined level of damages (stipulated sums)
 - Payable in the event of breach of contract
 - Designed to protect a legitimate interest
 - Most common use of LDs = Late completion of the Works

Outline of liquidated damages (cont'd)

- Purpose?
 - To provide an element of certainty to both parties as to what damages will be payable in the event that works do not complete on time.
- Contractual completion date:
 - Express time agreed for completion of the Works.
 - No express time agreed: reasonable time to complete (risk of time at large)

Penalties Doctrine: Scope

- LD clauses have always been subject to the rule against penalties

Makdessi v Cavendish Square [2015] 3 W.L.R. 1373

- Penalties doctrine applies to a provision operating upon breach of contract to make a payment or withhold a payment otherwise due.
 - Penal in amount
 - Penal in operation

Penalties Doctrine: Old Test

Dunlop Pneumatic Tyre Limited v New Garage & Motor Company Limited [1915] AC:

- Are the liquidated damages a genuine covenanted pre-estimate of loss which the employer would actually suffer for delay?

Penalties Doctrine: The New Test (Restated Test)

In 2015, the Supreme Court reviewed the law on penalty clauses and the concept of genuine pre-estimate of loss when it considered together the cases of:

Cavendish Square Holding BV v Talal El Makdessi [2015]
(UKSC 67)

- Commercial Share Sale Agreement
- Considered whether two clauses in an agreement for the sale and purchase of an advertising business amounted to unenforceable penalties.

ParkingEye Limited v Beavis [2015] (UKSC 67)

- Consumer parking fine dispute
- Considered whether a parking fine amounted to a penalty as Parkingeye did not suffer any specific financial loss.

Penalties Doctrine: The New Test (cont'd)

- The Supreme Court held:
- *“The true test is whether the impugned provision [i.e. the LAD clause].....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 [i.e. the obligation to complete the Works on time]. *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.*”*

Penalties Doctrine: The New Test (cont'd)

- *“The correct test for a penalty is whether the sum or remedy stipulated as a consequence of a breach of contract is exorbitant or unconscionable when regard is had to the innocent party’s interest in the performance of the contract.”*

LD clauses: Practical Guidance

- Do you have a negotiated contract between properly advised parties of comparable bargaining power?
- Is the clause a pre-estimate of loss? Even if it isn't, it is not automatically unenforceable
- The clause is unenforceable if it is penal
- Is the obligation to pay LD clause a primary or secondary obligation?
- Are the LDs “out of all proportion”, “unconscionable” or “extravagant”?
- The key is the detriment on the contract breaker vs. the legitimate interests of the innocent party.
- The legitimate interest can be commercial or otherwise.

Grounds for challenging LD claims

- Non compliance with contractual procedures e.g. condition precedents, notices, time for claiming/deduction of LDs
- Clause is a penalty
- Clause is void for uncertainty
- Failure to provide for extension of time entitlement
- Waiver

Relevant case law authorities

Case 1

Temloc Ltd v Errill Properties Ltd

- Rate of LDs was stated to be "£nil". Considered whether the LDs clause entitled the employer to nil damages.
- Court held
 - LD clause enforceable (nil damages for late completion)
 - Exhaustive remedy (i.e. no entitlement to claim general damages as an alternative)

Practical examples: 3 cases summarised

Case 2

North Midland Building Ltd v Cyden Homes Ltd

- Considered an amended JCT D&B 2005 contract in respect of concurrent delay.
- NM claimed 6 months EOT. CH allowed 9 days due to concurrent delay.
- NM sought court declaration that clause void.
- Court of Appeal held clause to be valid and unambiguous.
- May proceed to Supreme Court

Practical examples: 3 cases summarised

Case 3

Octoesse LLP v Trak Special Projects Ltd

- Considered clause 2.22 of a JCT Intermediate Building Contract 2011 and its effect on LDs.
- Clause 2.22 – *“If the Contractor fails to complete the Works or a Section by the relevant Completion Date, the Architect/Contract Administrator shall issue a certificate to that effect. If an extension of time is made after the issue of such a certificate, the extension shall cancel that certificate and the Architect/ Contract Administrator shall where necessary issue a further certificate.”*

Octoesse LLP v Trak Special Projects Ltd (cont'd)

- Certificate of non-completion issued
- Afterwards, 18-week EOT claimed. Only 9 weeks were awarded
- Contract Administrator/Architect failed to issue a further certificate of non-completion pushing to completion date out by the 9 weeks EOT granted
- Meant the Employer lost the entitlement to levy LDs as certification of non completion was an express condition

Claims procedure

When evaluating and preparing a possible claim, it is important to consider:

- Checking the contract provisions for conditions precedent and any clauses governing disputes;
- Consider whether your opponent has any insolvency or other financial issues;
- Consider adjudication or other alternative methods of dispute resolution;
- Consider the Pre-Action Protocol and the introduction of the new Disclosure Pilot Scheme in January 2019.

Conclusion

- Main purpose of LDs is to provide an element of certainty. Construction contracts usually contain conditions precedent.
- Grounds for challenging LD claims
- Now the true test under the penalties doctrine is whether the LDs clause imposes a detriment, which is out of all proportion to any legitimate interest.
- The courts have provided clear guidance in the recent case law authorities.
- Review the general claims procedure when considering a potential claim.

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Questions?