

# International Construction Webinar

## Liquidated Damages

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19 May 2016

# Section 1

## Basic Principles



# What are Liquidated Damages?

- Liquidated
  - Specific amount
  - Specified breach
  - Capable of calculation
  - With certainty
  - In advance
  
- Damages
  - A payment for a breach of contract
  - To compensate for the consequence of the breach
  - Liquidated damages are still just damages for breach
  
- Liquidated damages could be referred to as...
  - LADs (liquidated and ascertained damages)
  - Delay Damages (terminology under the NEC for of contract)
  - Delay Penalty (commonly seen in Middle East and international projects)

# Applying Liquidated Damages?

- What could liquidated damages attach to?
  - Late completion of the project or a defined part thereof
  - Quality breach?
  - Failure to achieve KPIs?
  
- While usually seen as detrimental to the paying party...
  - Liquidating the damages gives certainty of risk
  - The damages can be controlled and kept to a commercially acceptable level
  - Controlled level and certain risk should reduce the contract price
  
- More detailed look at time related liquidated damages

# Establishing Project Overrun

- Starting point is a clear and unambiguous obligation to complete by a specific date or within a specific time
  - No completion date, no liquidated damages
  - Inability to ascertain the completion date due to events on the project, no liquidated damages
  - Inability to alter the completion date by reason of the employers default, no liquidated damages
  - Therefore, completion is and needs to be a strict obligation not based on reasonable endeavours (a reasonable endeavours clause is likely to put time at large and leave liability to general damages)
  
- Assessing Delay
  - As planned impacted
  - Collapsed as-built
  - Windows
  
- Compliance with contract requirement, for example a certificate of non-completion

# General issues to be aware of

- Complete Remedy
  - A time related loss may have many facets, all will generally be covered by a LD clause attaching to late completion
  - If LDs for late completion are stated as nil then there are no damages recoverable at all
  - Only applies to the breach which the liquidated damage attaches to
  - The actual loss suffered is irrelevant as long as the liquidated amount has been properly arrived at
  
- Who makes the assessment and deduction
  
- Right not an obligation
  - Liquidated damages, generally, can be deducted but do not have to be
  - The deduction can, generally, be delayed or set aside entirely

## Section 2 Evaluation of Damages



# Previous position

- Four-limb test in *Dunlop Pneumatic Tyre Co v New Garage and Motor Co*:
  - Extravagant as compared to greatest loss which could be suffered from breach
  - Only breach is non-payment of money, but consequence is payment of higher sum
  - Same monetary amount or other consequence for different breaches
  - Not necessarily a penalty if difficult to difficult to pre-estimate true loss
- Test often thought to be whether LDs are “genuine pre-estimate of loss” – if not “genuine pre-estimate of loss”, must be a penalty
- Hence proliferation of contractual provisions: *“The parties agree that the liquidated damages are a genuine pre-estimate of loss ...”*



# Overview of Parking Eye

## ■ Facts:

- First case:
  - Sale of largest advertising business in Middle East
  - Purchase price to be paid in instalments
  - Non-complete clause – if breached, no further instalments payable
  - Sellers breached non-complete clause
  - Issue: was clause forfeiting further instalments a penalty?
- Second case:
  - Shopping centre car park
  - Parking free for 2 hours, then £85 charge
  - Local fish & chip shop owner overstayed but refused to pay charge
  - Issue: was £85 charge a penalty?

# Overview of Parking Eye (Cont.)

- Decision of the Supreme Court
  - Penalty rule is a long-standing principle of English law
  - But *Dunlop* and other tests being applied too rigidly
  - We are not changing anything...
- In negotiated commercial contracts, presumption that parties (not court) are best placed to judge what is legitimate
- May also be appropriate to consider innocent party's business as a whole
- Judgment can be found at <https://www.supremecourt.uk/cases/uksc-2015-0116.html> both in text and video

# Tests arising from Parking Eye

- Question 1: when does penalty rule potentially come into play?
  - Provisions operating on breach of contract
  - Courts do not otherwise regulate fairness of contracts
  - Note: this is a matter of substance, not form
  
- Question 2: is the provision a penalty?
  - “unconscionable”
  - “extravagant by reference to some norm”
  - “out of all proportion” to enforcement of the obligation

# Application of Parking Eye 1

- The first case – breach of advertising agreement
  - Provision forfeiting further instalments operated on breach – therefore within potential scope of penalty rule
  - Goodwill and non-compete essential to sale of business
  - Forfeiture of further instalments not a penalty

# Application of Parking Eye 2

- Second case – parking fine
  - £85 charge operated on breach – therefore within potential scope of penalty rule
  - Car park operator had interest in enforcing rules
  - Also had interest in recovering charge – was its only source of revenue for operating car park
  - Court compared charge to other commercial car parks and council car parks
  - Not a penalty (even though car park operator suffered no actual loss as a result of overstay)
  - Note: court referred to both parties having legitimate interest in enforcement of parking rules
  - Also reference to charge not being greater than required to ensure enforcement of rules

# Post-Parking Eye

- Test going forward? Helpful summary from Lord Mance:
  - *“What is necessary in each case is to consider, first, whether any (and if so what) legitimate business interest is served and protected by the clause, and, second, whether, assuming such an interest to exist, the provision made for the interest is nevertheless in the circumstances extravagant, exorbitant or unconscionable.”*
- Irrelevant whether:
  - “genuine pre-estimate of loss” (or not)
  - “deterrent”
- Look at interest innocent party is seeking to enforce – including in context of business as a whole
- Is provision unconscionable or extravagant as compared to that interest?

## Other Matters

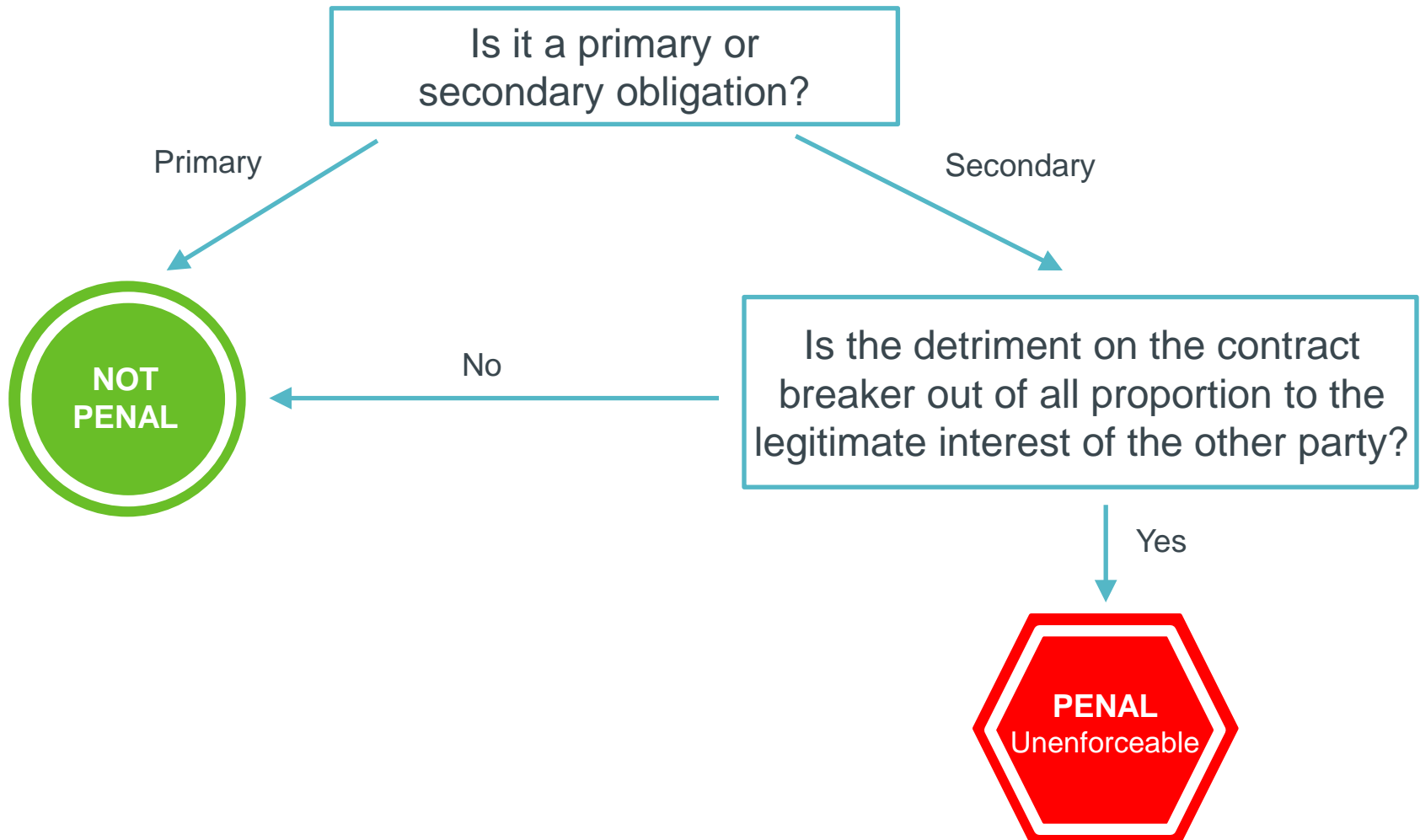
- Supreme Court recognised that penalty rule interferes with freedom of contract
- Also suggested courts should be slow to find provisions are a penalty
- Going forward, challenges to LDs less likely to succeed
- Note: even if provision is a penalty, still entitled to ordinary damages

# Primary vs secondary obligations


- Under English law, the penalty doctrine only applies to **secondary obligations** that arise out of a breach of contract
- *Stansfield Business International Pte Ltd v Vithya Sri Sumathis* [1998] 3 SLR (R) 927
  - Plaintiff school commenced proceedings against student for failing to pay outstanding school fees when she terminated her course prematurely.
  - Contract provided that she had to pay full fees even if she chose not to complete the course for the academic year.
  - Held: penalty rule was not operative as the school’s claim was for the contract sum (i.e. a primary obligation) and not damages payable upon a breach of the contract (secondary obligation).
- The test for a primary obligation: “*Can the penalty rule be applied without making a new contract for the parties?*” (will the contract still work?)



# When is the provision penal?



Section 4  
International position:  
common law and civil law



# Common law – Australia and Singapore

## ■ Australia

- *Andrews v Australia and New Zealand Banking Group Ltd*: Breach is not an essential aspect of the doctrine of penalties
- The High Court held it had equitable jurisdiction “*to relieve against any sufficiently onerous provision which was conditional upon a failure to observe some other provision, whether or not that failure was a breach of contract*”
- When a provision will be considered penal not resolved

## ■ Singapore

- Singapore Court of Appeal in *Xia Zhengyuan v Geng Changqing* applied *Dunlop* principles
- “Commercial justification”?
- Likely to follow *Parking Eye*

# Civil law – PRC

## ■ PRC Contract Law

- Parties may agree an amount based on the circumstances of a breach of contract, or the method for calculating the amount
- If petitioned by the parties, a court or arbitration institution may increase the amount, if the agreed amount is lower than losses incurred
- Conversely, a party can petition to have the amount reduced as appropriate if the agreed amount is \*excessively higher than losses incurred
  - ❖ *In accordance with the 2<sup>nd</sup> Interpretation of Contract Law of the Supreme People's Court the amount shall qualify as “excessively higher” if actual losses are 30% less than the agreed amount*
- Breaching party is still required to perform its obligations after paying liquidated damages for delayed performance

# Civil law/Sharia law – Middle East

## ■ UAE/Qatar

- Parties can pre-agree damages that will be payable
- UAE: Courts have discretion upon the application of either party to adjust damages payable and agreements contrary to this are void; courts have reduced preagreed compensation. It is rare for them to raise it.
- Qatar: Agreed compensation not payable if no loss incurred; court may reduce the compensation if grossly excessive or the obligation has been partially fulfilled. Agreements to the contrary are void; compensation can only be increased if debtor has committed deception or gross mistake

## ■ KSA

- Liquidated damages not commonly enforceable
- Courts look at actual damages suffered and award compensation accordingly (Sharia principle - “do no harm”)

# Section 4

## Practical Application and Issues



# Parking Eye in Practice

- What is a “legitimate business interest” in the construction sector?
- Cannot look at “construction” as one sector
  - Public
    - Transport
    - Central Government
    - Local Government
  - Private
    - Housing
    - Utilities
  - PPP
    - Social (health and education)
    - Infrastructure (roads)

# Forget what you can do... what do you want to achieve?

- Remember the purpose of the project in the first place, that purpose was NOT the recovery of damages for late delivery
- Purpose of a liquidated damages provision
  - Compensate the party who has performed
  - Incentivise (albeit it negatively) performance
  - Act as a deterrent
- The liquidated damages should not get in the way of performance
- Proper consideration to how and why the project is running late BEFORE the completion date is missed
- How do you ascertain responsibility for delay in the supply network below the main contractor



# Alternatives to Liquidated Damages

- Incentivised early completion
- Structured delay damages
  - Changing rates for changing periods
  - Capped delay damages
- Sectional damages only
- Focus on performance against KPIs not just time
- Liquidated damages bond or insurance

# Our Key Contacts



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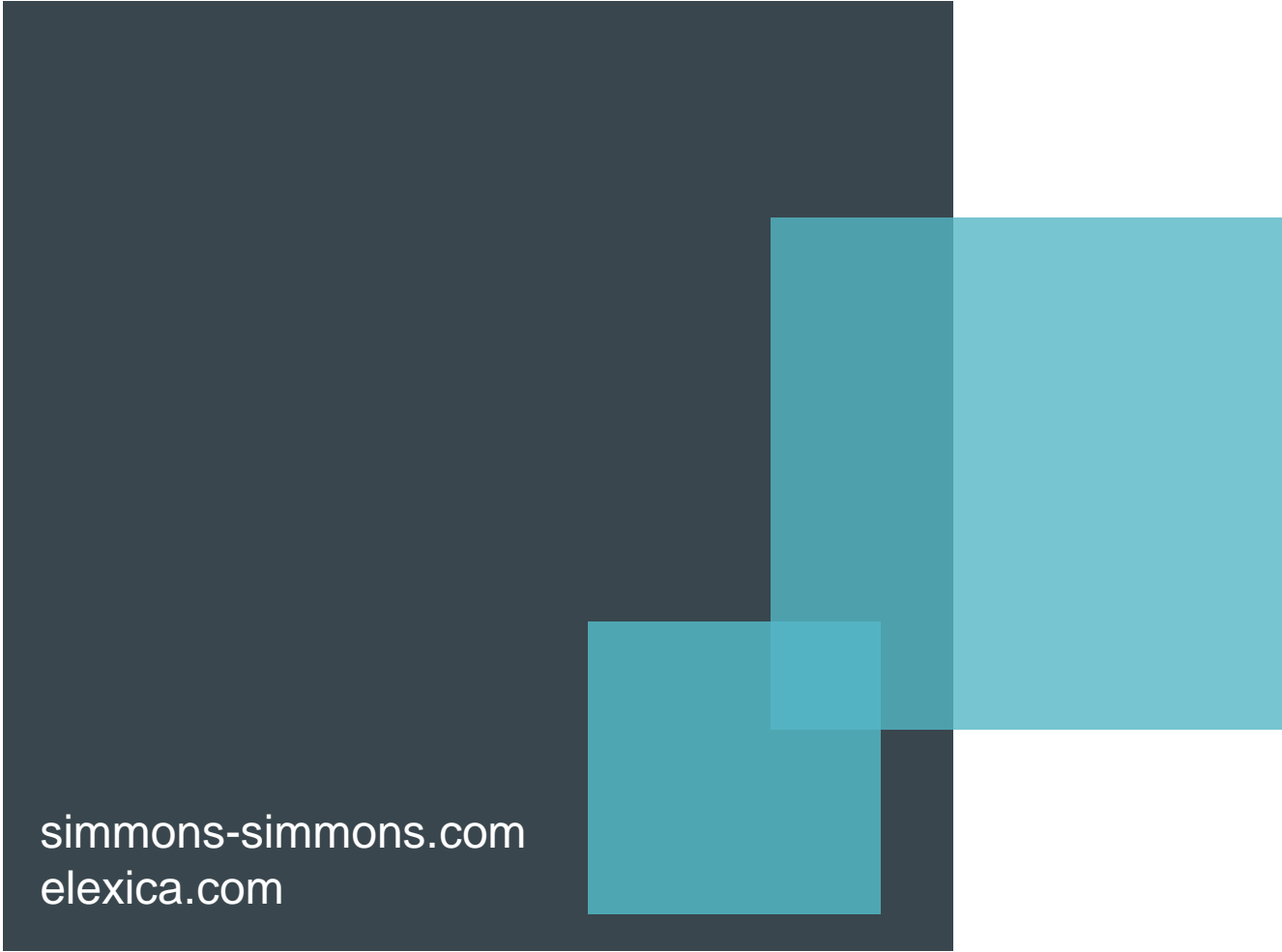


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