Chapter 12

Liquidated damages under JCT standard form contracts

12.1 Standard Building Contract (SBC)

12.1.1 Clauses 2.31 and 2.32

In the previous JCT Standard Form of Building Contract (JCT 98) the clause was 24. The current clauses are quite difficult to understand at first reading and architects and contractors must read them carefully several times.

12.1.2 Commentary

Conditions precedent to recovery

In a break from previous contracts, reference is made simply to 'liquidated damages' rather than 'liquidated and ascertained damages' (hence the common reference to 'LADs'). There is no difference in meaning and the shorter version is to be preferred. Four conditions must be satisfied before the employer is entitled to recover liquidated damages.

(1) The contractor must have failed to complete the Works by the date for completion in the contract or any extended time.
(2) The architect must have properly performed the duty to decide extensions of time under clause 2.32.
(3) The architect must have issued a certificate under clause 2.31 to the effect that the contractor has failed to complete by the completion date (a non-completion certificate).
(4) The employer must give a written notice to the contractor that liquidated damages may be deducted or may be required to be paid.

So far as the contract clause 2.32.1 is concerned, there are two contractual requirements which must be satisfied: the issue of the non-completion certificate and the employer's notice stating that liquidated damages may be deducted or payment may be required.

Building Contract Claims, Fifth Edition. David Chappell.

The case of *Token Construction Co Ltd v Charlton Estates Ltd*[1] is instructive. An architect sent a letter to the employer some time after contract completion which said 'with 13 weeks extension of time the adjusted completion date would have been 30.1.68 . . . Details of the 13 weeks' extension of time are being prepared and will be forwarded to you . . . liquidated damages ought to be calculated from 30 January 1968 to 15 July 1968, a period of 24 weeks.' The Court of Appeal held that the letter did not amount to either a certificate of delay or an extension of time. The Court found that the architect was not able validly to certify delay until having first considered and made decisions on all the contractor's applications for extensions of time. Although this was a decision on a special form of contract, it is thought that the decision also applies to SBC.

Certificate of non-completion

Contrary to popular belief, the architect may issue the non-completion certificate at any time prior to the issue of the final certificate. In practice, of course, most architects will issue the certificate immediately the completion date has passed in order to allow the employer the maximum possible time and maximum available funds for deduction of liquidated damages. An employer may have a cause of action against an architect who delays the issue of the certificate until just before the issue of the final certificate if by that time it is impossible to recover the liquidated damages. However, once the architect has issued the final certificate under clause 4.15, if no notice of adjudication, arbitration or legal proceedings has been given by either party in accordance with clause 1.9, the architect becomes *functus officio* and is excluded thereafter from issuing any valid certificate under clause 2.31 or indeed from taking any further action under the contract.[2]

The architect's non-completion certificate issued under clause 2.31 is not a condition precedent to arbitration on the question of recovery of liquidated damages although because the certificate is a condition precedent to recovery under the terms of the contract, the absence of such a certificate may well be decisive.[3] The architect cannot avoid issuing the certificate of non-completion if the contractor has failed to complete by the due date. It is not a matter for the architect's discretion. If the architect fixes a new date for completion after the issue of the certificate, the fixing of a new date is said to cancel the existing certificate and the architect must issue a further certificate (clause 2.31.3). If the employer is then found to have deducted too much by way of liquidated damages, the extra amount must be repaid.

Some problems with deductions

It has been, faintly, suggested by some commentators that the contractor would be entitled to interest on the money deducted and repaid. That suggestion is obviously misconceived. In recovering liquidated damages in the first instance, the employer

[1] (1973) 1 BLR 48.
[2] *H Fairweather Ltd v Asden Securities Ltd* (1979) 12 BLR 40.
[3] *Ramac Construction Co Ltd v J E Lesser (Properties) Ltd* [1975] 2 Lloyd's Rep 430.

was simply complying with an entitlement clearly set out in the contract. In repaying after a further non-completion certificate, the employer is again complying with the contract. In neither instance can the employer be said to be in breach of contract and, therefore, liable in damages. Therefore, it is difficult to see any justification for requiring interest to be paid unless the contract expressly so states. None of the JCT contracts give the contractor any entitlement to interest in such circumstances. The reason why the clause refers to the architect fixing a new date where it is necessary is because, if the architect fixes a new date which is the same as, or later than, the date the contractor actually completes the Works, a further certificate is unnecessary.

In *Reinwood Ltd v L Brown & Sons Ltd*[4] a decision of the House of Lords on JCT 98, the problem was that, on 14 December 2005, the architect issued a certificate of non-completion. On 11 January 2006, the architect issued an interim certificate. The final date for payment was 25 January. Two notices were served by the employer on the 17 January, one stating that it intended to deduct liquidated damages and the other stating the amount proposed to be paid. The balance was paid on the 20 January. However, on the 23 January, the architect issued an extension of time fixing a new date for completion as 11 January. Despite being notified by the contractor that liquidated damages were thus reduced and that the amount payable under the interim certificate had increased, the employer made no further payment before 26 January and the contractor served a default notice prior to termination and the employer paid the excess liquidated damages on the 1 February. Subsequently, the employer failed to pay a later certificate on time and the contractor, relying on the earlier notice, gave notice of termination of its employment.

The employer issued proceedings alleging repudiation on the part of the contractor. One of the contractor's crucial arguments was that, because the architect gave a further extension of time *before* the final date for payment of the interim certificate, the previous non-completion certificate was invalid and the employer should have paid the whole of the amount certified. In dismissing this view, the Lords held that, although the effect of the architect issuing a further extension of time was to invalidate the certificate of non-completion, the extension was issued after the certified sum excluding liquidated damages had been paid. Therefore, at the time of payment, the employer was correct and all its notices were valid. On the issue of the extension of time, the employer was obliged to repay the liquidated damages up to the new completion date within a reasonable time. The employer had paid promptly and was not in default.

The Lords briefly considered the position if the extension of time had been given after the withholding notice was served, but before the employer had paid. The Lords thought that there was a case for saying that the employer could not have relied on a withholding notice issued on the basis of a certificate of non-completion once the certificate had been cancelled by a fresh extension, but they acknowledged that there was also an argument that a withholding notice once validly served should be able to be relied upon even if the certificate on non-completion has become inoperative. Although a case on JCT 98, it is suggested that the principles apply to SBC also.

[4] (2008) 116 Con LR1.

Notice requiring payment

Clause 2.32.4 makes clear that the employer need only serve one notice requiring payment. It remains effective, unless the employer withdraws it, despite the cancellation by the architect of previous non-completion certificates and the issue of further non-completion certificates. Since the decision to deduct liquidated damages rests with the employer, it is unlikely that the notice would ever, in practice, be withdrawn. If the employer decided not to deduct damages, the matter would simply be allowed to rest.

The timing of the written notice sometimes causes difficulty. The wording seems to suggest that liquidated damages may be deducted provided that the written requirement is served before the date of the final certificate. That is the plain statement in clause 2.32.1. Thus it may appear that damages might be deducted from an interim certificate several months before a notice is served just before the issue of the final certificate. That, of course, would be nonsense and the purpose of the clause does not permit such a construction, because it uses the words 'has issued' and 'has notified'. It is perhaps unfortunate that the wording did not make clearer that the date of the final certificate is stated as the deadline for the written requirement and that the requirement must always pre-date the deduction.

Thus, it is good practice for the employer to issue the notice as soon as the architect has issued a non-completion certificate and that notice will serve for any future deductions. But it should be noted that failure to serve the written requirement at all before the final certificate will not only prevent deduction, it will also preclude recovery of the liquidated damages as a debt.

Some doubt has been thrown on the precise form to be taken by the employer's written requirement for payment under earlier versions of the standard form. Judge John Newey stated:

> 'There can be no doubt that a certificate of failure to complete given under clause 24.1 and a written requirement of payment or allowance under the middle part of clause 24.2.1 were conditions precedent to the making of deductions on account of liquidated damages or recovery of them under the latter part of clause 24.2.1.'[5]

This seems perfectly clear, but another Official Referee thought:

> '. . . that there was no condition precedent that the employer's requirement had to be in writing. What was essential was that the contractor should be in no doubt that the employer was exercising its power under 24.2 in reliance on the architect's certificate given under 24.1 and deducting specific sums from monies otherwise due under the contract.'[6]

The court, surprisingly, went on to hold that the written requirement was satisfied by a letter, written by the quantity surveyor and forwarded to the contractor, which stated the amount which the employer was entitled to deduct, alternatively, that the cheques issued by the employer from which liquidated damages had been deducted

[5] *A Bell and Son (Paddington) Ltd v CBF Residential Care and Housing Association* (1990) 46 BLR 102.
[6] *Jarvis Brent Ltd v Rowlinson Construction Ltd* (1990) 6 Const LJ 292.

constituted such written requirements. In *Holloway Holdings Ltd v Archway Business Centre Ltd*[7] a similar clause in IFC 84 was considered and it was again held:

> 'For (the employer) to be able to deduct liquidated damages there must both be a certificate from the Architect and a written request to (the contractor) from (the employer).'

The matter was finally clarified by a decision of the Court of Appeal in *J J Finnegan Ltd v Community Housing Association Ltd*[8] where the Court held that the decision in *Bell* was correct and that the employer's written requirement was a condition precedent to the deduction of liquidated damages. Only two things must be specified in the requirement and they are:

- whether the employer is claiming a payment or a deduction of the liquidated damages; and
- whether the requirement relates to the whole or part of the total liquidated damages.

SBC clause 2.32.1 leaves the matter in no doubt. Clause 2.32.4 emphasises that a requirement which has been stated in writing remains effective even if the architect issues further non-completion notices. Once the other conditions have been satisfied, the employer has until five days before the final date for payment to serve a notice on the contractor under clause 2.32.2.1 requiring payment and the employer may recover the amount as a debt (i.e. in the same way as any other debt) or the employer may serve notice, under clause 2.32.2.2 that the amount will be withheld from any sums due to the contractor. These clauses make clear that the employer is entitled to deduct liquidated damages at a lesser rate than the rate in the Contract Particulars. A footnote to the clause reminds the reader that if the employer is intending to withhold from the next certificate, the clause 2.32.2 notice must comply with the provisions of clauses 4.13.4 or 4.15.4 which deal with withholding notices either in respect of interim certificates or the final certificate respectively.

Summary

The conditions which must be satisfied before liquidated damages can be withheld are:

- The contractor must fail to complete by the contractual completion date or any extended date.
- The architect must have decided all extensions of time.
- The architect must have issued a non-completion certificate.
- The employer must serve a written requirement for payment or deduction.
- The employer must serve an effective written withholding notice.

The amount which the employer may deduct is to be calculated by reference to the rate stated in the Contract Particulars. The employer is free to reduce the rate, but

[7] 19 August 1991, unreported.
[8] (1995) 65 BLR 103.

not to increase it. Clause 2.32.1 makes clear that the employer need not wait until practical completion before deducting liquidated damages. Deduction may start as soon as the clause 2.31 certificate has been issued and the requirement for payment has been made. In practice, such deductions usually commence from the first payment thereafter.

12.2 Intermediate Building Contract (IC and ICD)

12.2.1 Clauses 2.22–2.24

In the previous JCT Intermediate Building Contract (IFC 98) the clause was 2.7. The current clause is quite difficult to understand at first reading and architects and contractors must read it carefully several times. Although there are two versions of this contract (IC and ICD) the liquidated damages clause is worded the same in both contracts.

12.2.2 Significant differences

This clause is very similar to SBC clause 2.32 in wording and in effect although here unaccountably spread over three numbered clauses. There is no express reference to the employer's right to require payment at a lesser rate than the one stated in the appendix, but in principle such a right must be implied. In any event, it is unlikely that a dispute would arise on the basis that the contractor insisted on paying the full rate.

12.3 Minor Works Building Contract (MW and MWD)

12.3.1 Clause 2.8 (under MW) or clause 2.9 (under MWD)

In the previous JCT Agreement for Minor Building Works (MW 98) the clause was 2.3. Although there are two versions of this contract (MW and MWD) the liquidated damages clause is identical in both contracts. References to clauses are to the clauses in MW. It is easy to transpose the clause numbers by changing clause 2.8–2.9 for MWD. Thus MW 2.8.2 becomes MWD 2.9.2.

12.3.2 Significant differences

The MW and MWD provision is much simpler than the clauses in SBC, IC and ICD. These provisions mark a very significant departure from the SBC, IC and ICD regime. There is no certificate of non-completion required from the architect which removes the necessity to state what must happen if a further extension of time is given and a further certificate is issued. The trigger is simply that the contractor fails to complete

the Works by the completion date or any extended date. Once that date is passed and the contractor is not finished, the employer may recover the amount of liquidated damages as a debt or may deduct it from any money due to the contractor under the contract.

It is common practice for architects to certify non-completion under this contract in any event. As it is not a certificate required by the contract, it has no particular standing. It merely represents the architect's opinion which the contract does not require the architect to give. Under clause 2.8.3, a written requirement by the employer has been introduced, once again with the date of issue of the final certificate as the deadline. However, as was noted in the commentary to SBC, common sense and implication of law would ensure that the notice must pre-date the deduction. In practice, the architect, complying with a general duty to advise the employer, will usually send a letter reminding the employer that the completion date has passed, that the contractor has not completed and that liquidated damages are deductible.

The normal withholding notices under the contract must also be served. Unlike SBC, IC and ICD, nothing is said about the need for the employer to repay liquidated damages if a further extension of time is given after damages have been deducted or paid. However, in such a case, the conditions which entitle the employer to liquidated damages (clause 2.8.2) would not be satisfied or at least varied and repayment would be an unavoidable consequence.

12.4 Design and Build Contract (DB)

12.4.1 Clause 2.29

In the previous JCT Standard Form of Building Contract with Contractor's Design (WCD 98) the clause was 24. The current clause is quite difficult to understand at first reading and architects and contractors must read it carefully several times.

12.4.2 Significant differences

There is a very distinct family resemblance between this form and SBC. The differences spring from the absence of an architect and the obligation of the contractor to complete the design of the Works. The main difference in this clause is that it is the employer, or, usually, the employer's agent acting on behalf of the employer, who issues a written notice of non-completion to the contractor (clause 2.28). Such a notice is intended to be a statement of fact. It is not the expression of an opinion such as would be the case if a certificate were to be issued.[9] The courts have refused to give a notice under this contract the same status as the certificate of an independent architect.[10]

[9] *Token Construction v Charlton Estates* (1973) 1 BLR 48.
[10] *J F Finnegan Ltd v Ford Seller Morris Developments Ltd* (1991) 53 BLR 38.

12.5 Prime Cost Building Contract (PCC)

12.5.1 Clauses 2.23 and 2.24

In the previous JCT Standard Form of Prime Cost Contract 1998 the clauses were 2.2–2.4.

12.5.2 Comments

Clauses 2.23 and 2.24 of PCC are virtually identical to the equivalent clauses 2.31 and 2.32 of SBC and the comments on SBC apply to PCC also.

12.6 Management Building Contract (MC)

12.6.1 Clauses 2.22 and 2.23

In the previous JCT Management Contract 1998 the clauses were 2.9–2.11.

12.6.2 Significant differences

The clause refers to the management contractor failing to secure completion of the project. This simply reflects the management contractor's obligation to secure the completion of the project by the completion date as set out in clause 2.3, i.e. its task is to arrange that others complete rather than to physically complete itself. Since the previous edition, these clauses have been significantly amended and the comments on SBC apply to MC also.

12.7 Construction Management Trade Contract (CM/TC)

12.7.1 Clause 2.32

There is no liquidated damages provision under this form of contract. Instead there is provision for recovery of unliquidated or actual damages. This is similar to the position under sub-contract forms. Although the client may suffer a loss as a result of delay on the part of a trade contractor, it is impossible to insert a liquidated sum, because several trade contractors may contribute to the loss.

12.7.2 Key points

Clause 2.32.1 contains two provisos. First, the trade contractor must have failed to complete within the completion period and, second, the construction manager must

have given all decisions on all extensions of time for which the contractor has submitted an application. It should be noted that clause 2.26.1 does not actually require the trade contractor to submit an application for extension of time but merely, as under SBC, to submit a notice of delay and the surrounding circumstances. There is unlikely to be much misunderstanding on the point, but there may be circumstances when the inconsistency in terminology between clauses becomes important. The trade contractor is obliged to 'pay or allow' direct loss and/or expense, but, in *Hermcrest plc v G Percy Trentham Ltd*,[11] a similar phrase was considered and the right to set-off the amount claimed by the party asserting the right to payment was expressly restricted to what was set out in the contract. Such set-off was limited to amounts agreed. Therefore, although there is an obligation to pay or to allow the sum properly due, it can be allowed only insofar as it is agreed and not if it is disputed.

Clause 2.32.2 provides for a cap on the amount if previously so agreed by the parties and written into the Contract Particulars. This is very useful for the trade contractor when the possible liability might be totally out of proportion to the value of the trade contract. This provision sets out formally what many trade and subcontractors already include as part of their routine qualification of quotations and tenders.

12.8 Major Project Construction Contract (MP)

12.8.1 Clause 16

In the previous Major Projects Form of Contract (MPF 03) the clause was 10.

12.8.2 Significant differences

This is a liquidated damages clause at its simplest. There is no requirement for a non-completion certificate, therefore, no need to provide for its cancellation and re-issue after as a further extension of time. The trigger is the contractor's failure to complete by the completion date, the rate is stated in the Contract Particulars and further extensions trigger repayment of any liquidated damages overpaid. Clause 16.1 refers to the contractor being liable to pay the employer liquidated damages. There is no express provision for the employer to deduct liquidated damages from payments to the contractor but, in this instance, that does not appear to preclude the employer from setting-off such damages from payments due to the contractor provided that the relevant withholding notices are served.

12.9 Measured Term Contract (MTC)

The current Measured Term Contract is the 2005 version (Revision 2 2009).

[11] (1991) 53 BLR 104.

12.9.1 Comments

There is no liquidated damages clause under this form of contract. Therefore, the employer is left to common law rights if the contractor fails to complete by the date for completion specified in an order or by any extended date. It would have been impossible to include a liquidated damages provision that is generally applicable to all orders, because the orders will relate to different kinds and values of work and different time periods. Any attempt to impose a general liquidated damages clause would result in the sum specified being a penalty and unenforceable under the principles set out in Section 3.2 of Chapter 3. The contractor's failure to complete is a breach of contract and the employer is left to prove the breach and the amount of damages suffered.[12]

12.10 Constructing Excellence Contract (CE)

The current JCT Constructing Excellence Contract is the 2006 version (Revision 1 2009).

12.10.1 Clause 7.27

The rate of liquidated damages is to be inserted in the Contract Particulars. If liquidated damages are stated to apply, but nothing is entered, the damages are to be unliquidated. That is to say, the purchaser will be left to its own devices to recover whatever damages it can prove it suffered as a result of late completion. The contract is silent about the position if the parties have not stated whether liquidated damages are to apply, but it ought to follow that in that instance also the damages would be unliquidated. Although these provisions avoid the purchaser being without a remedy if no rate is inserted, the purchaser will be without remedy if it inserts '£nil' as the rate. Liquidated damages will apply, but the rate will be £nil.[13]

Clause 7.27 is extremely brief, but none the worse for that. It simply states that the supplier is liable for liquidated damages at the rate in the Contract Particulars if it fails to complete the services by the date for completion. There is no requirement for a non-completion notice or certificate and the clause leaves it to the purchaser whether to deduct the damages or recover them as a debt. Obviously, if the purchaser intends to deduct the damages from a future payment a withholding notice will be necessary. However, unlike SBC, there is no requirement for a preliminary warning notice of the intention to deduct or seek payment.

[12] The damages principles in *Hadley v Baxendale* (1854) 9 Ex 341 apply.
[13] *Temloc Ltd v Errill Properties Ltd* (1987) 39 BLR 30.