Chapter 3
Liquidated damages

3.1 The meaning and purpose of liquidated damages

Liquidated damages means a fixed and agreed sum as opposed to unliquidated damages which is a sum which is neither fixed nor agreed, but must be proved in court, arbitration or adjudication. A more comprehensive definition of liquidated damages is given below. The addition of the words 'and ascertained' to 'liquidated damages' found in some contracts is not thought to be significant and the latest JCT series of contracts has dispensed with the additional wording.

Litigation is generally recognised as being expensive and lengthy. In order to recover damages in matters involving breaches of contract it is necessary to prove that the defendant had a contractual obligation to the claimant, that there was a failure to fulfil the obligation wholly or partly and that the claimant suffered loss or damage thereby. Very often it is clear that there is damage, but it is difficult and expensive to prove it.[1] To avoid that situation, the parties may decide, when they enter into a contract, that in the event of a breach of a particular kind the party in default will pay a stipulated sum to the other. This sum is termed liquidated damages.

In the building industry and elsewhere the terms 'liquidated damages' and 'penalty' are commonly used as though they were interchangeable. In fact, they are totally different in concept. Whereas liquidated damages are compensatory in nature and should be a genuine attempt to predict the damages likely to flow as a result of a particular breach, a penalty is a sum which is not related to probable damages, but rather stipulated *in terrorem*:[2] in other words, as a threat or even, in some instances, intended as a punishment. The courts will enforce the former, but not the latter though the parties may be no less agreed upon the matter in the first instance as in the second.[3] It is, therefore, of prime importance to establish into which category a particular sum will fall.

Building contracts usually include a date on which the contractor may take possession of the site and a further date by which it must have completed the building.[4] Alternatively, the contract may provide for a contract period which is triggered by a notice to commence,[5] or in some other way the building contract will provide a

[1] *Clydebank Engineering Co v Don Jose Yzquierdo y Castenada* [1905] AC 6.
[2] *Cellulose Acetate Silk Co Ltd v Widnes Foundry* [1933] AC 20.
[3] *Watts, Watts & Co Ltd v Mitsui & Co Ltd* [1917] All ER 501.
[4] For example, SBC Contract Particulars 1.1 and 2.4.
[5] For example, GC/Works/1(1998) clause 34.

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means of fixing the date on which building operations must be finished. It is established that the employer must give the contractor possession of the site on the due date and an employer who is in breach of that obligation is liable in damages.[6] Provided that the contractor is able to enter upon the site on the date stipulated for possession and thus to commence building work, it must finish by the completion date. If it fails to complete, the employer may recover such damages under the principles set out in *Hadley v Baxendale*[7] as can be proven were a direct result of the breach.

In practice, it may be difficult to allocate damages; which damages directly and naturally flow from the breach and which damages do not so flow but depend upon special knowledge which the contractor had at the time the contract was made. The amount of the damage is seldom easy to ascertain and prove.

For more than 100 years it has been the practice in the building industry to include a provision for liquidated damages in building contracts to avoid these difficulties. The way the provision is generally expressed is that the contractor must pay a certain sum to the employer for every week by which the original completion date is delayed. That sum must represent a genuine pre-estimate of the loss which the employer is likely to suffer.

3.2 Liquidated damages or penalty

3.2.1 The relevant law

It is extremely important that the sum entered into a contract is liquidated damages and not a penalty. The rules for deciding whether a sum is to be considered liquidated damages or a penalty were formulated by Lord Dunedin in *Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd*.[8] These are set out below with comment.

> '(i) Though the parties to a contract who use the words penalty or liquidated damages may prima facie be supposed to mean what they say, yet the expression used is not conclusive. The court must find out whether the payment stipulated is in truth a penalty or liquidated damages.'

It is not particularly relevant that the parties have agreed the sum as liquidated damages. Since *Kemble v Farren*,[9] the courts have paid little attention to the terminology adopted by the parties. In that case, not only was the sum expressed by the parties as liquidated damages, it was clearly stated that it was 'not a penalty or penal sum'. Notwithstanding the clear words, the court had little hesitation in finding that the sum was a penalty. In other cases, the courts have held that sums stated as penalties are in fact liquidated damages:

> 'All the circumstances which have been relied on in the different reported cases, as distinguishing liquidated damages from penalty, are to be found here. The

[6] *Rapid Building Group v Ealing Family Housing Association Ltd* (1984) 1 Con LR 1.
[7] (1854) 9 Ex 341.
[8] [1915] All ER 739.
[9] [1829] All ER 641.

> injury to be guarded against was one incapable of exact calculation. The sum to be paid is not the same for every default, for that which should occasion small as for that which should occasion great inconvenience, but one increasing as the inconvenience would become more and more pressing, and finally, the payments are themselves secured by the penalty of a bond.'[10]

Most modern forms of contract eschew the use of 'penalty' in favour of 'liquidated damages', but the term is often to be found in correspondence, site minutes and occasionally in forms of contract drafted by construction professionals. The term 'delay damages' which for no obvious good reason has been adopted by the NEC contract, seems to be equivalent to liquidated damages.

> '(ii) 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'[11]

A sum may be liquidated damages although it is not a genuine pre-estimate; for example if the sum is agreed at a lower figure. Some examples will be mentioned later.

> '(iii) The question whether a sum stipulated is a penalty or liquidated damages is a question of construction to be decided upon the terms and inherent circumstances of each particular contract, judged of as at the time of making the contract, not as at the time of the breach.'[12]

This rule is in two parts. First that the decision whether a sum is liquidated damages or penalty will hinge not only on the terms of a particular contract, but also on the inherent circumstances of that contract. The second part of the rule is that the terms and inherent circumstances to be considered are those existing at the time the contract was made, not when the term was breached. This is of importance when considering whether a sum is a genuine pre-estimate of loss, particularly when the likely damages were difficult or impossible to forecast at that time, but perfectly clear later. In looking at a sum, it should be considered in the worst possible light just as, if there are several possible breaches, 'the strength of the claim must be taken at is weakest link'[13]. Therefore, if a sum would not normally be considered to be a penalty, but under certain circumstances it would be penal, then it is to be treated as penal in its entirety and the court will not sever any part.

Stanor Electric Ltd v R Mansell Ltd,[14] provides an example of a sum held to be a penalty because of the circumstances in which it was sought to be applied. Liquidated damages expressed as a single sum for failure to complete two houses normally would present no problem. It was only the fact that one house was completed and taken into possession before the other which made the sum penal. It was not capable of division, because there was no provision in the contract allowing for the sum to be

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[10] *Ranger v Great Western Rail Co* [1854] All ER 321 at 332 per Lord Cranworth LC.
[11] *Clydebank Engineering Co v Don Jose Yzquierdo y Castenada* [1905] AC 6, was cited as authority for this proposition.
[12] *Public Works Commissioner v Hills* [1906] AC 368, [1906] All ER 919 and *Webster v Bosanquet* [1912] AC 394, were cited as authorities for this proposition.
[13] *Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd* [1915] All ER 739 at 743.
[14] (1988) CILL 399.

divided. The employer unsuccessfully attempted to deduct half the sum to represent one of the two houses. If both dwellings had been delayed by an equal amount, the sum would not have been held to be penal.

The principle is noticeable in the court's approach to hire purchase agreements. Very often, the sum to be paid on breach of the agreement by the hirer is not penal unless the breach occurs near the beginning of the hire period. Unless the sum is a genuine pre-estimate under all circumstances, it will not be upheld.[15] Two Hong Kong cases are instructive, because, although they indicate the same principle, they were overturned on appeal.[16] In each case, the liquidated damages provision in the contract was expressed in a complex form. At first instance, they were held to be void for uncertainty, because it was not easy to calculate the sum to be deducted at any particular stage, and the calculation could result in the sum being penal. The lesson appears to be that where complexities may arise, they should be severed from the primary liquidated damages provision.

In *Dunlop*, Lord Dunedin proceeded to set out tests which could prove helpful or even conclusive:

> '(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 which could conceivably be proved to have followed from the breach.'

This is probably the most important of the tests. It has been explained thus:

> 'I do not think the word "unconscionable" there has any reference to the fact that the parties were on an unequal footing. It does not bring in at all the idea of an unconscionable bargain. It is merely a synonym for something which is extravagant and exorbitant.'[17]

The fact that the sum stipulated as liquidated damages bears no relation to the contract sum is not relevant.[18] The correct burden of proof has been stated like this:

> 'The onus of showing such a stipulation is a "penalty clause" lies upon the party who is sued upon it. The terms of the clause may themselves be sufficient to give rise to the inference that it is not a genuine estimate of damage likely to be suffered but is a penalty. Terms which give rise to such an inference are discussed in Lord Dunedin's speech in *Dunlop Pneumatic Tyre Co v New Garage & Motor Co* [1915] AC 79 at 87. But it is an inference only and may be rebutted. Thus it may seem at first sight that the stipulated sum is extravagantly greater than any loss which is liable to result from the breach in the ordinary course of things, i.e. the so-called "first rule" in *Hadley v Baxendale* (1854) 9 Exch 341. This would give rise to the prima facie inference that the stipulated sum was a penalty. But the plaintiff may be able to show that owing to special circumstances outside "the ordinary course of things" a breach in those special circumstances would be liable

[15] *Landom Trust Ltd v Hurrell* [1955] 1 All ER 839.
[16] *Arnold and Co Ltd v Attorney General of Hong Kong* (1990) 47 BLR 129 CA (Hong Kong), (1989) 5 Const LJ 263 and *Philips Hong Kong Ltd v Attorney General of Hong Kong* (1993) 61 BLR 41 PC, (1991) 7 Const LJ 340 CA (Hong Kong), (1990) 50 BLR 122.
[17] *Imperial Tobacco Co v Parsley* [1936] 2 All ER 515 at 521 per Lord Wright MR.
[18] *Imperial Tobacco Co v Parsley* [1936] 2 All ER 515 at 524 per Lord Slesser LJ.

to cause him a greater loss of which the stipulated sum does represent a genuine estimate.'[19]

There appears to be no case where a sum stipulated as liquidated damages in respect of breach of a single obligation has been held to be a penalty on these grounds. The importance of this test probably lies in its application to multiple breaches or to breaches of multiple obligations.

'(b) It will be held to be a penalty if the breach consists only in not paying a sum of money, and the sum stipulated is a sum greater than the sum which ought to have been paid.'

Lord Dunedin referred to this test as 'one of the most ancient instances'. An example of the operation of this principle is to be found in *Kemble v Farren*,[20] where a comedian was engaged to appear on certain nights for £3 6s 8d per night. The contract provided that if either party failed to fulfil the agreement or any part, the party in default would pay the other a sum of £1,000. Tindall CJ said:

'But that a very large sum should become immediately payable in consequence of the non-payment of a very small sum, and that the former should not be considered as a penalty, appears to be a contradiction in terms; the case being precisely that in which the courts of equity have always relieved . . . '.[21]

Although of little application to building contracts, it probably relies on the fact that where the breach lies in failure to pay a known sum of money, the likely damages are capable of precise calculation, being the sum itself together with, in certain circumstances, interest. Therefore, any greater sum must be a penalty.

'(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 damages"'.[22]

The application of this principle is clearly to be seen in *Ariston SRL v Charley Records Ltd*,[23] where a sum of money claimable if certain manufacturing parts were not returned within 10 working days was held to be a penalty, because the same sum was payable whether the whole or just a few of the parts were late and in the latter case, the sum would be extravagant in relation to the greatest likely loss. It is suggested that the principle is the key to some other decisions in relation to building contracts where there have been no proper provisions for dividing a single sum, expressed as liquidated damages, to allow for the completion and taking into possession of part of a building.[24]

It is common for the provisions for the rate of liquidated damages in contracts to be completed by stating 'at the rate of £XXX per week or part thereof'. That is

[19] *Robophone Facilities Ltd v Blank* [1966] 3 All ER 128 at 142 per Diplock LJ.
[20] [1829] All ER 641.
[21] [1829] All ER 641 at 642 per Tindall CJ.
[22] *Lord Elphinstone v Monkland Iron & Coal Co* (1886) 11 App Cas 332 at 342 per Lord Watson
[23] *The Independent*, 13 April 1990.
[24] See, for example, *Stanor Electric v R Mansell* (1988) CILL 399 and *MJ Gleeson v Hillingdon Borough Council* (1970) 215 EG 165.

probably because at one time that form of words was printed in a standard form. It is likely that the intention behind the inclusion of that phrase is to indicate that the rate will be reduced pro rata the proportion of the week excluded from consideration. Of course, the phrase does not mean that. What it means, in simple terms is 'at the rate of £XXX for each whole week and at £XXX for any part of a week' which is why standard forms do not use the expression. There is a presumption that the provision amounts to a penalty, because it purports to levy the same rate of liquidated damages whether the delay is a whole week or only one day (or indeed one hour) of that week. If the rate is correct for a week, it must be excessive for an hour. It is a presumption which can be rebutted, for example by showing that the employer's damages begin to accrue at the very beginning of the week. An example might be a week's rent that becomes payable immediately the week commences.

> '(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 the contrary, that is just the situation when it is probable that pre-estimated damage was the true bargain between the parties.'[25]

This principle is of overriding importance in situations where the other tests have produced an inconclusive result.

There is a strong inference that a sum is liquidated damages where the parties have agreed a sum or sums as liquidated damages and the sum claimed is not excessive in relation to the actual loss suffered. It has been neatly summed up:

> 'The fact that the issue has to be determined objectively, judged at the date the contract was made, does not mean what actually happens subsequently is irrelevant. On the contrary it can provide valuable evidence as to what could reasonably be expected to be the loss at the time the contract was made.'[26]

3.2.2 Recent developments

More recently, the Court of Appeal set out four principles to differentiate liquidated damages from a penalty:[27]

(1) The parties intentions must be identified by examining the substance rather than the form of words used.
(2) A sum would not be a penalty where a genuine pre-estimate of loss had been carried out.
(3) The contract should be construed at the time the contract was made, not at the time of the breach.
(4) It would be a penalty if the amount was extravagant or unconscionable compared to the greatest foreseeable loss.

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[25] *Clydebank Engineering Co v Don Jose Yzquierdo y Castenada* [1905] All ER 251 and *Webster v Bosanquet* [1912] AC 394 were cited as authority for this proposition.
[26] *Philips Hong Kong Ltd v The Attorney- General of Hong Kong* (1993) 61 BLR 41 at 59 per Lord Woolf repeated in *Ballast Wiltshire PLC v Thomas Barnes & Sons Ltd*, unreported, 29 July 1998 at paragraph 50 per Judge Bowsher.
[27] *Jeancharm Ltd v Barnet Football Club Ltd* [2003] EWCA Civ 58 at paragraph 27 per Gibson LJ.

In *North Sea Ventilation Ltd v Consafe Engineering Ltd,* liquidated damages were expressed in the contract as sums of money which increased in proportion to the seriousness of the breach.[28] The court held that such an arrangement was a characteristic clause and it did not amount to a penalty.

It has been pointed out that the categories of a genuine pre-estimate of loss or a penalty does not cover all possibilities.[29] Some clauses may operate when a breach occurs, but may fall into neither category, but be perfectly justifiable.

In a recent case, a contract was entered into between a luxury yacht builder and a prospective purchaser. By the terms of the contract, the builder agreed to construct a yacht and the purchaser agreed to pay €38 million for it, payable in instalments. One of the terms of the contract stated that, on lawful termination by the builder, the builder was entitled to retain out of payments made or recover from the purchaser 20% of the price, as liquidated damages. Any balance of sums received was to be returned to the purchaser. In addition, the builder retained the yacht.

When the purchaser failed to pay the first instalment, the builder terminated and sued the purchaser for the 20% liquidated damages less only an amount the purchaser had paid by way of deposit. The court held that the clause was not a penalty:

> 'the evidence clearly shows that the purpose of the clause was not deterrent, and that it was commercially justifiable as providing a balance between the parties upon lawful termination by the builder. I do not accept the defendant's submission that the court has to form a view as to the maximum possible loss that the parties would have expected to flow from any determination of the contract and the extent to which the stipulated figure for liquidated damages exceeded that maximum possible loss, and that since it cannot do so without extensive disclosure, and factual and expert evidence, the defendant must be permitted to defend the claim. This was a contract for the construction and sale of a very expensive yacht, aptly described in the evidence as a 'super-yacht'. Both parties had the benefit of expert representation in the conclusion of the contract. The terms, including the liquidated damages clause, were freely entered into. As the authorities referred to above show, in a commercial contract of this kind, what the parties have agreed should normally be upheld. In my view, the clause in question is not even arguably a penalty, and is enforceable in its terms. It follows that the claimant is entitled to summary judgment for €7.1m being 20% of the contract price of €38m less €0.5m paid by way of deposit.'[30]

The reason for the court's decision seems to be that the clause was specifically negotiated by two parties who were both legally advised and the clause could benefit either party depending on when it was operated. Having said that, it is clear that although towards the end of the contract, the builder would receive only 20% of the contract price on termination, the builder was entitled to retain the yacht. However, the builder may have difficulty in selling the completed yacht to another buyer at 80% of the contract price.

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[28] 20 July 2004 unreported.
[29] *Cine Bes Filmcilik VE Yapimcilik v United International Pictures* [2003] All ER (D) 312 (Nov).
[30] *Azimut-Benetti SpA (Benetti Division) v Healey* (2010) 132 Con LR 113 at 126 per Blair J.

It is not easy to see how this case will directly translate into guidance for the building industry. It is more likely to be an indication that the courts are open to new ways of formulating such clauses.

3.2.3 Summary

It may be useful at this stage to summarise the effect of the rules and tests in the light of other judicial decisions:

(a) Where there is a single event and the pre-estimate of likely loss is relatively easy, a sum will be a penalty if it is greater than such loss, but otherwise liquidated damages.[31]
(b) Where there is a single event and the pre-estimate of likely loss is difficult, the sum is more likely to be liquidated damages as the difficulty of pre-estimation increases.[32]
(c) Where there are several events and the pre-estimate of likely loss in respect of any one of them is relatively easy, a sum will be a penalty if it is greater than such loss, but liquidated damages otherwise.
(d) Where there are several events and the pre-estimate of likely loss is difficult, the sum is likely to be liquidated damages, but other factors must be taken into account:
    (i) If one sum is payable in respect of several events which result in different kinds and amounts of loss, it is likely to be a penalty.[33]
    (ii) If one sum is payable in respect of several events and the damage is the same in kind, but giving rise to differing amounts of loss, it may be liquidated damages.[34]
    (iii) If one sum is expressly stated to be an average of the pre- estimated loss resulting from each of several events, it is likely to be liquidated damages.[35]
    (iv) Where different sums are payable in respect of different events, they are likely to be liquidated damages.[36]

The two important considerations are the extent to which an accurate pre-estimate of loss can be carried out and the existence of different events, each of which are said to give rise to liquidated damages. But the decision of the Privy Council of the House of Lords in *Philips Hong Kong Ltd v Attorney General of Hong Kong*, is significant. The Law Lords held that hypothetical situations cannot be used to defeat a liquidated damages clause. The court will take a pragmatic approach:

> 'Whatever the degree of care exercised by the draftsman it will still be almost inevitable that an ingenious argument can be developed for saying that in a particular hypothetical situation a substantially higher sum will be recovered than would be recoverable if the plaintiff was required to prove his actual loss in that

[31] *Kemble v Farren* [1829] All ER 641.
[32] *Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd* [1915] All ER 739.
[33] *Ford Motor Co v Armstrong* (1915) 31 TLR 267.
[34] *Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd* [1915] All ER 739.
[35] *English Hop Growers v Dering* [1928] 2 KB 174.
[36] *Imperial Tobacco Co v Parsley* [1936] 2 All ER 515.

situation. Such a result would undermine the whole purpose of the parties to a contract being able to agree beforehand what damages are to be recoverable in the event of a breach of contract. This would not be in the interest of either of the parties to the contract since it is to their advantage that they should be able to know with a reasonable degree of certainty the extent of their liability and the risks which they run as a result of entering into the contract.'[37]

Subsequent decisions of the courts have confirmed that they favour a pragmatic approach and they are not likely to decide that a sum is a penalty based purely on hypothetical rather than factual grounds:

'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.'[38]

In that case, important factors were that the parties had comparable bargaining power, it was a commercial contract and the level of damages survived scrutiny by the parties' legal advisors. Perhaps most important was that the court was following the lead set by higher courts and was predisposed to uphold terms which fix the level of damages.

3.3 Liquidated damages as limitation of liability

It appears that a sum will be classed as liquidated damages if it can be said of it that it is a genuine pre-estimate of the loss or damage which would probably arise as a result of the particular breach.[39] The figure inserted in the contract must be a careful and honest attempt to accurately calculate the loss or damage which will be suffered and it must be a pre-estimate in the sense that it must be an estimate at the time the contract is made, not at the time of the breach[40]. However, it has been said:

'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.'[41]

The court's view appears to be that the great advantage to the parties of having a definite figure outweighs any disadvantage caused by the figure being somewhat greater than the likely damages. It seems that the courts are disposed to accept a figure for liquidated damages which is unlikely provided it does not strain probability. In practice, most figures inserted in contracts to represent liquidated damages are substantially less than the likely level of damages.

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[37] (1993) 61 BLR 41 at 54 per Lord Woolf.
[38] *Alfred McAlpine Capital Projects Ltd v Tilebox Ltd* (2005) 104 Con LR 39 at 50 per Jackson J. See also *Lordsvale Finance v Bank of Gambia* [1996] QB 752 and *Indian Airlines v GIA International* [2002] EWHC 2361 (Comm).
[39] *Philips Hong Kong Ltd v Attorney General of Hong Kong* (1993) 61 BLR 41PC.
[40] *Public Works Commissioners v Hills* [1906] All ER 919, [1906] AC 368.
[41] *Alfred McAlpine Capital Projects Ltd v Tilebox Ltd* (2005) 104 Con LR 39 at 50 per Jackson J.

It appears that the courts will not strike down a sum which is less than that which would represent an accurate forecast of probable loss. Such a sum may have been inserted, because a party wished to limit its liability:

> 'I agree that it is not a pre-estimate of actual damage. I think it must have been obvious to both parties that the actual damage would be much more than £20 a week, but it was intended to go towards the damage, and it was all that the sellers were prepared to pay. I find it impossible to believe that the sellers, who were quoting for delivery at nine months without any liability, undertook delivery at eighteen weeks, and in so doing, when they engaged to pay £20 a week, in fact made themselves liable to pay full compensation for all loss.'[42]

Clauses inserted as limitations of liability must now be examined in the light of the Unfair Contract Terms Act 1977. Section 3, in part, states that:

> 'This section applies as between contracting parties where one of them deals as a consumer or on the other's written standard terms of business . . . . As against that party, the other cannot by reference to any contract term . . . when himself in breach of contract, exclude or restrict any liability of his in respect of the breach . . . except in so far as (in any of the cases mentioned above in this subsection) the contract term satisfies the requirement of reasonableness.'

Where it can be shown that the lower sum was inserted as a limitation of liability and where one party deals on the other's standard written terms of business, the term must satisfy the requirements of reasonableness set out in Section 11 and Schedule 2. In most building industry cases, the limitation of liability should be easily attributable to the application of sound business principles. It should not be ruled out that, in some instances, the limitation could be shown to be unreasonable and, therefore, unenforceable. In most cases, the liquidated damages are inserted into the contract by the employer and they are thought of as being for the employer's benefit. Therefore, if they are less than one might expect, a reasonable assumption is that the employer had good reasons for inserting the lower figure.

3.4 Sums greater than a genuine pre-estimate

It also seems that the courts are willing to countenance sums which are greater than that which would constitute a genuine pre-estimate in certain limited circumstances. The point was considered in *The Angelic Star*.[43] The case arose in connection with repayment of a substantial loan, on which the borrowers defaulted. A term of the agreement required immediate repayment of the whole sum of the outstanding balance on default. The Court of Appeal held that the provision was not a penalty, per Gibson LJ:

> 'Parties to a contract are free expressly to stipulate not only the primary obligations and rights under the contract but also the secondary rights and obligations,

[42] *Cellulose Acetate Silk Co Ltd v Widnes Foundry* (1925) Ltd [1933] AC 20 at 23 per Lord Atkin.
[43] [1988] 1 Lloyd's Rep 122.

i.e. those which arise upon non-performance of any primary obligation by one of the parties to the contract'.[44]

This was subject to the rule of public policy against enforcing sums which the court is not satisfied are genuine estimates of the loss likely to be sustained. The court appears to have looked upon the repayment provision as a form of liquidated damages. The decision is difficult to reconcile with the principle that it is a penalty when a larger sum is made payable on breach of an obligation to pay a smaller sum.

The principles of genuine pre-estimate also apply where the damages are expressed other than as money: for example, if a breach of obligations is to give rise to a transfer of property as liquidated damages.[45]

3.5 Liquidated damages as an exhaustive remedy

3.5.1 Liquidated damages as the only remedy

A question often arises whether a party to a contract containing a liquidated damages clause can sue for actual damages suffered or whether the party is restricted to the sum expressed as liquidated damages. In principle, where parties enter into a contract, it must be assumed that they know what they are doing and that the contract is an expression of their intentions.[46] It follows that if parties agree that in the event of a particular kind of breach liquidated damages are payable by the party in breach, that agreement will be upheld by the courts and they will be allowed no other or alternative damages but the damages liquidated in the contract.

The sum expressed as liquidated damages was held to be exhaustive of the remedies available to the claimant for late completion in *Temloc Ltd v Errill Properties Ltd* where the amount of liquidated damages was stated to be '£nil'.[47] It was held that the parties had agreed that, in the event of late completion, no damages should be applied. Even if a rate had been stated, the court considered that the rate would have represented an exhaustive agreement as to damages which were or were not to be payable by the contractor in event of his failure to complete on time. That, of course, does not preclude the employer from recovering as unliquidated damages other losses not directly caused by the breach of obligation to complete, but which may be connected to such breach. In *Piggott Foundations Ltd v Shepherd Construction Ltd*[48] the court followed *Temloc* and held that liquidated damages were exhaustive of the damages which could be recovered for failure to complete the Works on time.

It should be noted that the CE contract and GC/Works/1(1998) both provide that if no rate of liquidated damages is inserted in the contract, the employer's remedy will revert to unliquidated damages. A difficult question sometimes arises under traditional forms of contract where there is space to insert a rate (e.g. in the Contract

[44] *The Angelic Star* [1988] 1 Lloyd's Rep 122 at 127.
[45] *Jobson v Johnson* [1989] 1 All ER 621.
[46] *Liverpool City Council v Irwin* [1976] 2 All ER 39.
[47] (1987) 39 BLR 30, referred with approval in *Biffa Waste Services Ltd & Another v Maschinenfabrik Ernst Hese GmbH & Another* (2008) 118 Con LR 104.
[48] (1993) 42 Con LR 98.

Particulars of SBC) and no rate is inserted, the space is left blank, but unlike the position under CE, the contract does not provide for that eventuality. Another variation is for the entry in the Contract Particulars to be crossed out. The intention may be that the liquidated damages clause is not to apply (why then not simply delete the clause itself?) or that it applies but no rate is to be charged. In other words that the employer does not intend to charge any kind of damages for late completion. That is unusual and it is suggested that the contract would have to indicate very clearly that such a situation was intended.

It is tentatively suggested that where the parties simply omit to insert any rate, they have rendered the clause inoperative and that liquidated damages cannot apply. The employer is left to recover whatever unliquidated damages can be proved. That may not necessarily be the case where the parties have crossed out the entry in the Contract Particulars. Where parties omit to insert any rate, the most likely explanation is that it was overlooked or that it was left to be inserted when a suitable figure was calculated, it does not suggest that the parties have deliberately omitted the figure so as to leave the rate at £Nil. If '£Nil' was intended, it could be inserted. However, where the parties have taken the trouble to cross out the entry (but not inserted any rate), the most likely explanation is that they did not want any rate to apply.

A recent Australian case considered the insertion of '$00' as the rate and concluded that the parties intended that liquidated damages would not apply and the employer could seek unliquidated damages instead. The clause in question (clause 11.9) stated:

> 'If the Builder breaches sub-clause 11.1, it shall be liable to pay the Proprietor liquidated damages at the rate of NIL DOLLARS ($00.00) per day for each day beyond the due date for practical completion until practical completion is deemed to have taken place.'

In considering the clause the court concluded:

> 'The insertion of "NIL DOLLARS ($00.00)" in cl 11.9 in the contract does not, therefore, necessarily evince an intention that the respondents are to have no remedy in damages in the event of delay. It is consistent with an intention to make it clear that the provision in the standard form contract allowing for liquidated damages is to have no effect and that the respondents are to be left with the burden of proving such damage as they may be able to establish.'[49]

It is difficult to see the logic behind that conclusion albeit the clause is substantially different from the one considered in *Temloc Ltd v Errill Properties Ltd*.[50] Although the *Temloc* case decided by the Court of Appeal is the precedent in this jurisdiction, it should not be discounted that on the basis of a different form of contract, an English court might come to a different conclusion.

In *M J Gleeson plc v Taylor Woodrow Constructions Ltd*[51] the court refused to allow the set-off of sums for which a liquidated damages figure had been inserted in the contract and already deducted. This was on the straightforward principle that

[49] *J-Corp Pty Ltd v Mladenis & Another* (2009) 131 Con LR 188 at 201 per Newnes JA.
[50] (1987) 39 BLR 30.
[51] (1989) 49 BLR 95.

damages cannot be recovered twice for the same breach of contract. This view is supported by earlier decisions.[52]

This principle should be distinguished from the situation where the defendant is in breach of two or more obligations, for one of which the stipulated remedy is liquidated damages and for the other(s) the remedy is to sue for unliquidated damages. A related situation is where there is but one breach which gives rise to a loss which may be said to trigger a remedy in liquidated damages and a separate kind of loss for which other damages are appropriate.

The former situation is illustrated in *E Turner & Sons Ltd v Mathind Ltd*,[53] where a number of flats were to be completed in stages and there was a final completion date for the whole development. Liquidated damages were stipulated only for failure to meet the final completion date. Although expressed *obiter*, it was the view of the Court of Appeal that the liquidated damages clause, standing alone, was not an effective exclusion of any right to damages for earlier breaches of obligation. There was every reason to suppose that the parties intended the staging provisions to be contractual, possibly leading to a higher contract price. Without a specific overriding provision, breach of such provisions results in damages.

The decision was curious because the development was carried out on the basis of the Standard Form of Building Contract 1963 Edition (JCT 63). It had a provision in clause 12(1) which was similar to the current clause 1.3 of SBC to the effect that nothing in the bills of quantities was to override, modify or affect in any way whatsoever the application or interpretation of the 'Conditions'. This provision, although contrary to the normal rule that 'type prevails over print' has been upheld by the courts.[54] The staging provision was to be found mainly in the bills of quantities, but possibly also in other documents although the position was somewhat unclear. Therefore, it might be thought that the provisions in the bills of quantities were ineffective, because they attempted to override, modify or effect the single date for completion in the printed form. Clearly, in this instance, the court thought otherwise.

The only other case in point had been *M G Gleeson (Contractors) Ltd v Hillingdon Borough Council*,[55] where the argument really seems to have been about whether the single sum of liquidated damages could be distributed over the stages noted in the bills of quantities. The court had held that, on the basis of clause 12(1), such an interpretation could not be upheld. It is interesting to speculate whether the claimant in that case would have met with more success had it argued that there were two distinct breaches: breach of the obligation to complete the whole development on a fixed date for which the remedy was a sum set as liquidated damages; and breach or breaches of the obligation to comply with a set of intermediate dates for which the remedy was unliquidated damages. The court in *Turner* was referred to this case, but distinguished it on the basis that the *Gleeson* contract was a deed and it was not permissible to look outside the contract documents. Moreover, in the *Turner* case, the provisions for intermediate phasing were not only contained in the bill of

[52] See *Diestal v Stevenson* [1906] 2 KB 345 and *Talley v Wolsey-Neech* (1978) 38 P & CR 45, where the courts prevented the claimants from recovering amounts greater than those stipulated by way of liquidated damages.
[53] (1986) 5 Const LJ 273 CA.
[54] See, for example, *English Industrial Estates Corporation v George Wimpey & Co Ltd* [1973] 1 Lloyd's Rep 51.
[55] (1970) 215 EG 165.

quantities but also in the construction sequence drawing and possibly in other documents which the court thought may have been incorporated (although not in the printed form).

In this context, it is useful to look at *Ford Motor Company v Armstrong*,[56] where the claimants agreed that the defendant should sell their motor cars. The defendant was to pay the claimants the sum of £250 if in breach of the agreement in any of the three following ways: by selling cars or parts at below the list price; by selling cars to persons or firms engaged in the motor car industry; or by exhibiting cars at any exhibition without the claimants' written permission. A majority of the Court of Appeal held the provision to be a penalty, and therefore unenforceable, on the basis that the breaches were not of the same kind. The claimants had argued that the reasoning behind the provision was to guard against damage to their business by the wholesale undercutting of the list prices. To that extent, the argument was the same as was put forward in *Dunlop v New Motor*.

The argument failed, because the breaches in *Dunlop*, although different in degree, were of the same type and each of the breaches could clearly be seen to have the same ultimate effect. In *Ford*, the breaches were quite different, in degree, type and result. The deciding factor appears to have been the fact that the same figure of £250 could not be considered as a genuine pre- estimate in respect of each of the three sets of breaches. On the basis of the judgment, it appears that the claimants could have avoided trouble by fixing different sums in respect of the three types of breaches. Alternatively, they could have fixed a sum of liquidated damages for the breach of selling below list price and sued in respect of the other breaches to obtain whatever damages they could prove.

3.5.2 Where there are two breaches

It is debatable whether there were two breaches or just one in the situation considered in *Aktieselskabet Reidar v Arcos*.[57] This concerned delay in loading cargo for which demurrage was stipulated. The meaning of demurrage has been stated thus:

> 'The word "demurrage" no doubt properly signifies the agreed additional payment (generally per day) for an allowed detention beyond a period either specified in or to be collected from the instrument; but it has also a popular or more general meaning of compensation for undue detention . . . '.[58]

This meaning is very close to liquidated damages, particularly as commonly encountered in a construction situation, i.e. for delay in completion. The court appears to have dealt with demurrage in exactly the same way as liquidated damages. The principles to be derived from this case are thought-provoking. In essence, the facts are simple. The defendants failed to load a cargo at the agreed rate and as a result the ship was detained beyond the time stipulated. The delay also meant that the ship was only allowed to carry a winter cargo instead of the heavier summer cargo and the

[56] (1915) 31 TLR 267.
[57] [1926] All ER 140.
[58] *Lockhart v Falk* (1875) LR 10 Exch at 135 per Cleasby B.

claimants suffered loss of freight. The claimants brought the action to recover demurrage (liquidated damages) for the period the ship was detained in port beyond the lay (allowed) days together with, as damages, the difference between the amount of freight the claimants would have earned if the defendants had loaded at the correct rate and the amount which they did earn.

The members of the Court of Appeal took different approaches to the problem. Banks LJ thought that the obligation to load a full and complete cargo and the obligation to load the cargo at a stipulated rate were separate obligations. He went on to say:

> 'At one time I was inclined to think that, where parties had agreed a demurrage rate, the contract should be construed as one fixing the rate of damages for any breach of the obligation to load or discharge in a given time. On further consideration I do not think that such a view is sound. I can find no authority on the point, and it is noticeable that in the *Saxon Steamship Case* [59] it was not suggested that the claim for demurrage excluded the additional claim for special damage arising from the detention of this vessel.'[60]

Atkin LJ held that the 'provisions as to demurrage quantify the damages not for the complete breach, but only such damages as arise from the detention of the vessel.'[61] Sargant LJ was of the opinion that 'the same delay in loading, which might give rise to a claim for detention, also resulted in a breach of the obligation to load a full cargo,'[62] but there was a definite separate loss. There is no doubt that the defendants were in breach of their obligation to load at a specified rate. The breach caused them to overrun their allotted time. The result of that was an obligation to compensate the claimants by liquidated damages. If, by overrunning the time period, the defendants had been able to load the agreed amount of cargo, the claimant's only loss would have arisen from the overrun itself, and liquidated damages would have been adequate. That is clearly what the parties contemplated at the date of the charterparty. The overrun, however, resulted in the defendant's failure to load the specified cargo in order to comply with the regulations for winter cargo which only applied as a result of the overrun. So the claimants suffered the additional loss due to a smaller cargo. If the cargo had been loaded at a rather quicker rate, it might have been possible for the full cargo to have been loaded before the winter rate applied.

The rate of loading is significant in that when it fell below a particular figure, it triggered the second breach. *Aktieselskabet Reidar* was considered in the House of Lords where it was thought that 'There was a breach separate from although arising from the same circumstances as the delay . . . '[63] and that 'there were in that case breaches of two quite independent obligations; one was demurrage for detention . . . the other was a failure to load a full and complete cargo . . . '.[64]

In *Total Transport Corporation v Amoco Trading Co (The 'Altus')*, the judge considered *Aktieselskabet Reidar v Arcos* and concluded:

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[59] *Saxon Steamship Co Ltd v Union Steamship Co Ltd* (1900) 69 LJQB 907.
[60] *Aktieselskabet Reidar v Arcos Ltd* [1926] All ER 140 at 145.
[61] *Aktieselskabet Reidar v Arcos Ltd* [1926] All ER 140 at 145.
[62] [1926] All ER 140 at 147.
[63] *Suisse Atlantique, etc. v N V Rotterdamsche Kolen Centrale* [1966] 2 All ER 61 at 77 per Lord Hodson.
[64] [1966] 2 All ER 61 at 83 per Lord Upjohn.

> 'I must treat the ratio decidendi of the case as being that where a charterer commits any breach, even if it is only one breach, of his obligation either to provide the minimum contractual load or to detain the vessel for no longer than the stipulated period, the owner is entitled not only to the liquidated damages directly recoverable for the breach of the obligation to load (dead freight) or for the breach of the obligation with regard to detention (demurrage), but also for, in the first case, to the damages flowing indirectly or consequentially from any failure to load a complete cargo if there is such a failure.'[65]

He proceeded to hold that where the charterer was in breach of his obligation to provide the minimum load, the owner was entitled to the damages flowing directly or indirectly from the failure in addition to liquidated damages for the breach of such obligation. On the facts of the case he was probably right. The probable consequences of the breach were known to both parties. It is difficult to accept his analysis of *Aktieselskabet*. The correct analysis must surely be that one default gave rise to two breaches because of the particular circumstances. Liquidated damages are certainly due as a result of the first breach and further damages may be due as a result of the second breach depending upon the facts.[66] The essential principle to be extracted from these cases is that although a breach for which liquidated damages are specified will give rise to such damages, they may not be the limit of a party's entitlement to damage resulting from the breach. This view appears to be supported by Nourse LJ:

> 'The damages payable in respect of late completion of the works are one head of the general damages which may be recoverable by an employer for the contractor's breach of a building contract.'[67]

It is similar to the situation which sometimes occurs in building when a development must be completed by a particular date or it is ineligible for a grant. There, the failure to complete by the completion date would attract liquidated damages. Failure to complete by the further cut-off date for grant purposes would deprive the employer of the grant, but whether an employer could recover that amount from the builder would depend on whether it could be brought within the principles of special damages[68] i.e. whether the parties could reasonably be supposed to have contemplated such a result from the breach at the time they made the contract.

3.6 Injunction

Although a party cannot opt for unliquidated damages if liquidated damages have been set out in the contract, it seems that, if appropriate, a party may opt for an injunction instead. In *General Accident Assurance Corporation v Noel*,[69] it was held that where a party was in breach of a covenant in restraint of trade, the injured party

[65] [1985] 1 Lloyd's Rep 423 at 435 per Webster J.
[66] *Koufos v Czarnikow Ltd (The Heron II)* [1969] 1 AC 350 HL.
[67] *Temloc Ltd v Errill Properties Ltd* (1987) 39 BLR 30 at 30.
[68] See the full discussion of special damages in Chapter 5, Section 5.2.
[69] [1902] 1 KB 377: a case dealing with a covenant in restraint of trade.

could not have both an injunction to restrain further breaches and liquidated damages in respect of the breaches already committed. The court concluded that the claimants had an option to elect between, but could not have both remedies. It is suggested that this is the correct answer to the problem posed when a party commits this kind of breach. If it is assumed that the breach must cause the innocent party undoubted but not readily quantifiable harm, liquidated damages appears ideally suited to the situation. But if the award of damages, as in this case, is expressed as a single sum, it may be argued that if the damages are paid, the party in effect has a licence to carry on committing the breach, because the injured party can recover no more. The answer to that argument seems to be that a party had the opportunity to make an appropriate bargain. An appropriate bargain in this case might well have been to have stipulated not a single sum as liquidated damages, but a sum for every week that the breach continued or, as in *Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd*, for each separate breach. If a single lump sum is stipulated, it must be assumed that it is calculated on the basis that any breach, whether brief or protracted would have the same overall effect on the claimant's trade. Although that may be questioned in theory, in practical terms there is much to commend that approach.[70] It has been said, although probably *obiter*:

> 'Where there are different breaches and the agreement provides for a particular sum of liquidated damages to be payable for each and every breach, there is no bar to awarding the liquidated damages amount for each breach which has occurred to date of trial and also awarding an injunction to restrain future breaches.'[71]

The judge went on to say that there was no double recovery, because the two remedies were referable to different breaches. This contention seems to ignore two principles. The first is that where liquidated damages are stipulated they are exhaustive of the remedies available for a breach, and the second is that an injunction is normally refused if damages would be an adequate remedy. By agreeing a figure, be it a single sum or a sum for each breach, the parties are accepting that it is a complete remedy. This is the very foundation of the principle of liquidated damages. Under normal circumstances, the point has little application to a building situation. Liquidated damages are normally expressed as being payable for failure to complete by the contract completion date. Such a breach is not susceptible to easy remedy by injunction. Special constructional works, however, may require particular provisions to which these principles may apply.

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[70] *English Hop Growers v Dering* [1928] 2 KB 174. The decision in *General Accident v Noel* should be compared to *The Imperial Tobacco Co Ltd v Parsley*. This case has been quoted as authority for the proposition that a party can recover liquidated damages and obtain an injunction where the sum stipulated as liquidated damages is graded according to the extent of the breach. The case concerned a price maintenance agreement by which the defendant undertook to pay the claimants £15 for every sale in breach of the agreement. The trial judge granted an injunction to restrain further breaches, but he refused to enforce the series of £15 payments on the basis that they were really penalties. As there was no appeal on the injunction, but only on the question whether the payments were penalties or liquidated damages, this case appears shaky ground on which to found any contention that both liquidated damages and an injunction are available remedies in certain instances.

[71] *Lorna P Elsley, Executrix of the Estate of Donald Champion Elsley v J G Collins Insurance Agencies Ltd* (1978) 4 Const LJ 318 at 320 per Dickson J. This Canadian case concerned a covenant in restraint of trade on breach of which the defendant was to pay liquidated damages.

3.7 Liquidated damages in relation to loss

The next question is whether a claimant is entitled to recover the amount specified as liquidated damages if the damage actually suffered is less than the amount or nothing at all. Indeed, is a claimant able to recover liquidated damages though it can be demonstrated that it has actually gained from the breach? It is settled that a party can recover liquidated damages without being put to proof of actual loss.[72] If that is correct, it seems obvious that in some instances the actual loss will be greater and sometimes less than the sum in the contract. Indeed, it follows that in certain instances there will be no loss whatever.

The principle was applied in *BFI Group of Companies Ltd v DCB Integration Systems Ltd*.[73] There, on an appeal from the award of an arbitrator, it was found that, although the claimants had suffered no actual loss as a result of being unable to use two vehicle bays, because they had, in any event, to execute fit out works after possession before being able to attract revenue, they were entitled to liquidated damages. The form of contract was on MW 80 terms and provided for the payment of liquidated damages if completion was delayed beyond the completion date. The claimants were given possession by the contractor on the extended date for completion although the arbitrator found that practical completion had not taken place. Had they not been given possession, they would have been obliged to wait until practical completion was certified before being able to execute the fit-out works. Unlike other forms of contract, such as SBC, IC or ICD, in MW and MWD there is no provision for possession of part of the Works before practical completion and the possession granted to the claimants in this case was a concession. Therefore, the claimants were able to carry out work during the period within which they were receiving liquidated damages. This represented a considerable advantage to the claimant.

A similar point arose in *Golden Bay Realty Pte Ltd v Orchard Twelve Investments Pte Ltd*, [74] an appeal to the Privy Council concerning liquidated damages in an agreement for the sale and purchase of commercial property. Lord Oliver, speaking of the calculation of the damages expressed the view of the Privy Council that it was

> 'difficult to support as a genuine pre-estimate of the damage likely to be suffered from delay in completion in any case. Particularly this would be so in a case in which the building is complete at the date of the contract and the purchaser is let into possession under the terms of the contract.'[75]

The purpose intended in this instance was to enable the claimant, among other things, to commence the fit-out works. It is difficult to fault the conclusion in *BFI v DCB* on the facts as found by the arbitrator. The clear words of most contracts allow liquidated damages for the period between the date when the Works should have reached completion until the date of practical completion. Unless possession is taken by the employer strictly in accordance with the contract terms, unlawful possession

[72] *Clydebank Engineering Co v Don Jose Yzquierdo y Castenada* [1905] AC 6.
[73] (1987) CILL 348.
[74] [1991] 1 WLR 981.
[75] [1991] 1 WLR 981 at 986.

by the employer is not a trigger for the end of liquidated damages, despite what many adjudicators appear to think.[76]

3.8 Where there is no breach of contract

It seems that the question whether a sum stipulated for payment on the happening of a particular event is a penalty or liquidated damages will be irrelevant if the event does not constitute a breach of obligation on the part of one of the parties. The situation has frequently arisen in connection with, but it is not confined to, hire purchase agreements. In *Associated Distributors Ltd v Hall and Hall*[77] the agreement provided that the hirer was entitled to determine the agreement. The owner was also entitled to determine if the hirer was in default with payments. On determination for any reason, the hirer must pay certain sums of money to the owners. Slesser LJ summarised the position in this way:

> 'This is a case where the hirer has elected to terminate the hiring. He has exercised an option, and the terms on which he may exercise the option are those set out in clause 7. The question, therefore, whether these payments constitute liquidated damages or penalty does not arise in the present case for determination.'[78]

This approach appeals as a very straightforward solution to the problem. *Lombard North Central PLC v Butterworth*[79] was a case dealing with the hire of computer equipment. The parties had stipulated that certain terms were to be treated as conditions. One of these terms was that on the hirer's failure to pay any single instalment, the owner was entitled to recover the goods together with arrears of rentals, all further rentals which would have fallen due and damages for breach of the agreement. It was held not to be a penalty.

The right of parties to make their own bargain within specified limits has long been sacred and that seems to be the key to unravelling these decisions. It has been said:

> '. . . one purpose, 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 loss actually suffered by the plaintiff as a result of the breach by the defendant. But it is not and never has been for the courts to relieve a party from the consequences of what may in the event prove to be an onerous or possibly even a commercially imprudent bargain.'[80]

The case concerned a number of interlocking contracts of great complexity. In essence, the matter for consideration was whether breach of an obligation by one

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[76] In *Impresa Castelli SpA v Cola Holdings Ltd* (2002) 87 Con LR123, the employer had occupied part of the Works, but not under the partial possession clause of WCD 98. It was held that such occupation did not amount to partial possession, there was no mechanism to reduce liquidated damages and, therefore, the full amount of liquidated damages could be recovered.

[77] [1938] 1 All ER 511 CA.

[78] [1938] 1 All ER 511 CA at 513.

[79] [1987] QB 527.

[80] *Export Credits Guarantee Department v Universal Oil* [1983] 2 All ER 205 at 222 per Lord Roskill.

party to another could give rise to payment by a third party or was such a payment to be considered a penalty and therefore unenforceable. A significant statement was made in the course of the appeal:

> '. . . the mere fact that a person contracts to pay another person, on a specified contingency, a sum of money which far exceeds the damage likely to be suffered by the recipient as a result of that contingency does not by itself render the provision void as a penalty.'[81]

The House of Lords concurred with this view. These and other similar cases give food for thought in the context of building industry contracts.[82] In each of the cases, the sum of money is payable on the occurrence of an event. This event is the termination. The difficulties seem to have arisen due to the specified grounds for termination. In each case, termination may take place at the instance of either party and some of the grounds for termination by the owner are breaches by the hirer. In one of the cases, even trivial breaches were made conditions so as to enable the owner to terminate.

Lord Denning drew attention to what he termed the 'absurd paradox' that if a hirer under a hire purchase agreement lawfully terminated the agreement, he would not be able to say the sum then payable by him according to the terms of the agreement was a penalty, but he would be able to do so about the same term if the agreement was terminated as a result of his breach of contract.[83]

The courts seem to be agreed that no question of liquidated damages or penalties arise unless a breach of contract is involved. A Hong Kong case put this line of reasoning into effect in a construction contract.[84] But where a sum is payable on one of several events, some being breaches and some simply options, the courts have been less sure. In some instances they have avoided the issue by concentrating on the precise matter before them and ignoring the wider connotations; such a case was *Associated Distributers* where only the hirer's option to terminate was considered.

This point gives rise to interesting speculation with regard to the provision for liquidated damages in building contracts. It is common practice that a contractor, in pricing its tender, will take account of the stipulated amount of liquidated damages. If it considers that the period stated for completing the work is insufficient, the contractor may decide upon the period it requires and calculate the difference in liquidated damages, adding the amount to its tender figure (although almost certainly disguised). It could be said that such a contractor who completes the work in, say, ten months instead of nine months is exercising an option. In building contracts, time is not of the essence, because there is provision for extending time in certain specified instances. However, if the contractor fails to complete by the contract completion date, it is in breach of contract and there is now authority from the Court of Appeal that liquidated damages are not an agreed price to permit the contractor to continue its breach of contract.[85]

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[81] [1983] 2 All ER 205 at 215 per Slade LJ.
[82] See also *Cooden Engineering Co Ltd v Stanford* [1952] 2 All ER 915 CA; *Campbell Discount Co Ltd v Bridge* [1962] AC 600; *Re Apex Supply Co Ltd* [1941] 3 All ER 473; *Alder v Moore* (1961) 2 QB 57 CA.
[83] *Campbell Discount Co Ltd v Bridge* [1962] AC 600 at 629.
[84] *Icos Vibro Ltd v SFK Construction Management Ltd* (1992) APCLR 305.
[85] *Bath and North East Somerset District Council v Mowlem* (2004) 100 Con LR 1.

If an otherwise penal sum were to be inserted, the employer may be able to argue that the sum payable was not a penalty following a breach, but simply the figure agreed by the parties as payable on the contractor opting to complete later than the contract completion date. In the hiring cases, there is an express clause which permits either party to terminate. There is no express clause in building contracts to enable the contractor to exceed the stipulated contract period. Although the contractor cannot claim that liquidated damages is an agreed price enabling it to continue its breach of contract, there appears to remain the possibility that the employer could give the contractor that option. It is interesting to speculate that, on that argument, a single sum would not be struck out on the basis that it was 'extravagant and unconscionable'.[86]

3.9 Calculation of liquidated damages

Pre-estimation of loss is seldom easy. The employer may have little idea how much loss he or she may suffer if the building is not completed by the due date, particularly if the contract period is to be counted in years rather than months. Although it has been held that liquidated damages are especially suited to situations where precise estimation is almost impossible,[87] the employer should try to calculate as accurate a figure as possible. The employer should include every item of additional cost which can be predicted will flow directly from the contractor's failure to complete on the due date; that is, the damages recoverable under the first limb of the rule in *Hadley v Baxendale*. It seems that the sum can be increased to include amounts which would normally only be recoverable under the second limb if the employer can show that special circumstances were involved.[88] It remains unclear whether, in the case of liquidated damages, the special circumstances must be known to the contractor when the contract is made. It seems appropriate to reveal such circumstances at tender stage although it could be argued that the higher figure for liquidated damages is itself a sufficient prior notification.

From a purely practical point of view, an employer will very often reduce such a figure in order to make the proposed damages more palatable to prospective tenderers. The Association of Consultant Architects Form of Building Agreement (ACA 3; see Chapter 16) is alone among standard forms of main contract in providing for unliquidated damages as an alternative. Some local authorities and other public bodies make use of a formula calculation which basically depends upon a percentage of the capital sum. Whether that would constitute liquidated damages will depend on the precise circumstances and particularly the difficulty with which a precise calculation could be made. Use of a formula is a perfectly sensible approach where it is obvious that substantial loss will be suffered in the event of a delay, but where it is virtually impossible to calculate precisely in advance what that loss would be.[89]

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[86] *Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd* [1915] All ER 739 at 742 per Lord Dunedin.
[87] *Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd* [1915] All ER 739.
[88] *Philips Hong Kong Ltd v Attorney General of Hong Kong* (1993) 61 BLR 41. A format/checklist for calculating liquidated damages is to be found in Chappell, Cowlin and Dunn's *Building Law Encyclopaedia* (2009) Wiley-Blackwell.
[89] *Philips Hong Kong Ltd v The Attorney General of Hong Kong* (1993) 61 BLR 41 PC.

In *Multiplex Constructions Pty Ltd v Abgarus Pty Ltd & Another*[90] a specially drafted liquidated damages clause was held to be entirely valid and enforceable despite the absence of any specified sum. The damages were expressed as two parts. The first part was to be the interest calculated with reference to Trading Banks on daily balances of the total of items listed in the clause. The items included: 'Payments made by the Proprietor under any contract relating to the execution of the Works' and 'Reasonable costs and expenses incurred by the Proprietor in enforcing or attempting to enforce any contract relating to the execution of the Works'. The other items were equally imprecise. The second part was rates, statutory charges 'and other reasonable outgoings . . . '.

Although referred to in the contract and by the court as 'liquidated damages', it is difficult to see how such a clause can justify that description. An important aspect of liquidated damages is that it is a known amount at the time the parties enter into the contract. Although that does not preclude the damages being expressed as a method of calculation, such a method should be known to have a certain result in any given set of circumstances. In *Multiplex* the individual items could not always be ascertained. Works such as 'charges assessed', 'reasonable costs', 'reasonably necessary' and 'reasonable outgoings' introduce elements of judgment which have no place in the calculation of liquidated damages after the event. Employers introducing clauses of that kind are simply courting disputes.

Liquidated damages need not be expressed in monetary terms. It can be expressed in terms of a transfer of property. In *Jobson v Johnson*,[91] the contract provided that shares in a football club were to be purchased by payment of a lump sum followed by six instalments. If there was a default in paying the instalments, the contract provided that the shares were to be transferred back and the lump sum only would be repaid. The Court of Appeal held that it was a penalty because the transfer of shares took no account of the valuation of the shares or the amount paid in instalments. The payment was the same irrespective of the consequences of the breach of obligation to pay instalments. However, the court confirmed that transfer of property could be liquidated damages and no distinction was to be drawn between transfer of property or payment of money.

3.10 Where there is partial possession

Provisions for the deduction of liquidated damages often run into trouble where the employer decides to take partial possession of the Works. In *M J Gleeson (Contractors) Ltd v Hillingdon Borough Council*,[92] the contract for the construction of blocks of houses provided for liquidated damages at the rate of £5 per dwelling per week. Only one date in the contract was stipulated as the completion date, but the bills of quantities which formed part of the contract provided for the Works to be completed in sections. The employer attempted to deduct liquidated damages with reference to the sectional dates for completion set out in the bills. It was held that clause 12 in

[90] [1992] APCLR 252.
[91] [1989] 1 All ER 621.
[92] (1970) 215 EG 165.

the contract (to similar effect to clause 1.3 of SBC) prevented the bills from overriding the printed contract and, therefore, the contract completion date prevailed. Consequently, as soon as the employer started to take possession of the houses, liquidated damages were no longer deductible.

In *Bramall & Ogden v Sheffield City Council*[93] the council required the construction of 123 houses. There was no sectional completion in the JCT 63 contract being used. There was provision for partial possession in clause 6 and the appendix stated the rate of liquidated damages as £20 per week for each uncompleted dwelling. The problem in that case was that the partial possession clause made provision for liquidated damages to be calculated by proportioning the liquidated damages in the same ratio as the value of the part taken into possession bore to the contract sum. That is straightforward and similar to current partial possession clauses. However, that provision assumes that the rate of liquidated damages in the appendix is one sum per week. In this case, the sum had already been split into a rate per dwelling. The court summarised the contractor's argument as follows:

> 'The works cover not only the houses but the other items above referred to. Clause 22 refers to a failure "to complete the works" by the extended date. As from that date the employer becomes entitled to liquidated damages until the works are completed. Clause 16 deals with the consensual taking of possession of part of the works. Clause 16(e) provides for the sum payable after taking possession in respect of the period during which the works remain incomplete. The way in which the liquidated damages are dealt with is set out in the appendix. This does not allow of the calculation to be made which is required by condition 16(e), and one cannot operate the appendix and condition 16(e) in the circumstances of this case. The inconsistency can only be reconciled if provision is made in the contract for sectional completion of those parts which are taken over and to which specific liquidated damages provisions are applied.'[94]

Counsel for the employer suggested that the inconsistency could be overcome by the simple expedient of expressing the rate as 123 dwellings × £20 = £2,460. The court rejected that approach.

The *Bramall* case has been followed in *Avoncroft Construction Ltd v Sharba Homes (CN) Ltd.*[95] Although the case was mainly concerned with an adjudicator's decision and a party's attempt to set-off against it, the court expressly stated that the liquidated damages clause failed according to the principle in the *Bramall* case. Partial possession was taken. The contract (JCT 98) had no provision for sectional completion and the liquidated damages could not apply. The *ratio* in the *Stanor* case noted earlier is a similar principle.

In SBC, IC and ICD, the partial possession clauses provide that the liquidated damages will be proportioned in the same way as the value of the part taken into possession bears to the contract sum. It has already been seen that this formula will work only if the rate of liquidated damages in the Contract Particulars is expressed as a single sum in respect of the whole of the Works. Any attempt to express it as a

[93] (1983) 1 Con LR 30.
[94] (1983) 1 Con LR 30 at 35 per Judge Hawser.
[95] (2008) 119 Con LR 130.

figure for various parts of the Works (as in the *Bramall* case) will render the liquidated damages clause unworkable.

There may still be difficulties even if the rate is expressed as a single, and therefore divisible, amount. The principal difficulty concerns the proportioning of the liquidated damages. Since the figure representing liquidated damages is for the whole of the Works, there is no problem, in principle, in dividing it up to represent the part of the Works not taken into possession. The problem may arise in the simplistic approach to the division. It is possible to envisage a situation where proportioning in the same ratio as the value taken into possession may not properly represent a genuine pre-estimate of the damage. The value is usually calculated by the quantity surveyor using the rates and prices in the bills of quantity. It could easily be the case that the proportionate value of a certain part of the Works is greatly in excess of its bill of quantities value. Take the case of a complex of buildings, one of which houses all the key parts of a central heating system or computer network serving the whole complex. The key building will have a substantial bill of quantities value, but it may not represent the true value of the building if, for example, it stopped working. The cost of getting in temporary services may be enormous. If the proportioning does not throw up realistic figures for liquidated damages, it may be argued that one or more of the figures are penalties. In which case, the whole of the liquidated damages would be rendered ineffective (see Section 3.2.1). Generally, modern courts are less inclined to interfere with liquidated damages provisions. Where the differences are trivial, it is unlikely that the courts will throw out the liquidated damages provisions, but they may be more inclined to do so if it can be shown that the differences are significant and the parties could have easily arranged to split the complex into sections.

3.11 Maximum recovery if sum is a penalty

A practical problem concerns the employer's position if liquidated damages are held to be a penalty. Is the employer restricted to recovery of such amount as can be proved up to, but not greater than, the amount of the sum held to be penal? Some commentators have come to the conclusion that the amount stipulated as a penalty is not a ceiling on the amount of damages recoverable, while another thinks the question is still open, at least in so far as building contracts are concerned.[96] In an early judgment in the Court of Appeal, Kay LJ traced the effect of courts of equity on sums stipulated as penalties and noted that if the actual damages could easily be estimated, 'the penalty would be cut down and the actual damage suffered would be assessed.'[97] No qualification is placed upon the statement and, at face value, it could be taken as authority for the assessment of damage of any amount, even greater than the penalty sum itself. It would probably be going too far to construe the remarks in that way, since removing a penalty in favour of actual

[96] Stephen Furst and Vivian Ramsey, *Keating on Construction Contracts* (2008) 8th edition, Sweet & Maxwell at 319.

[97] *Law v Redditch Local Board* [1892] All ER 839 at 895.

damages is hardly likely to have been equitable if it resulted in the sum payable being thereby increased.[98]

A strong argument against the penal sum being a ceiling on possible damages is to be found in the following extract:

> 'Now where a contract contains a clause which is in form indisputably a penalty clause the position of the parties was thus described by Lord Mansfield in *Lowe v Peers*[99]: "There is this difference between covenants in general, and covenants secured by a penalty or forfeiture. In the latter case the obligee has his election. He may either bring an action of debt for the penalty, and recover the penalty; (after which recovery of the penalty he cannot resort to the covenant, because the penalty is to be in satisfaction for the whole;) or, if he does not choose to go for the penalty, he may proceed upon the covenant, and recover more or less than the penalty toties quoties"'.[100]

The effect of that appears to be that, where a sum is held to be a penalty, a party may take action on the penalty and obtain judgment, but the court will only allow execution of the judgment up to the penal sum. However, the party may opt to disregard the penalty, in which case, he may sue for and recover the full amount of damages suffered even if they exceed the penalty figure. Because one definition of a penalty is that it is 'extravagant and unconscionable in comparison with the greatest loss which could conceivably be proved to have followed from the breach', it will be rare that actual damages exceed the penalty figure.[101]

However, there will be some situations where a sum is held to be a penalty because it consists of one sum payable on the happening of a number of different breaches, some resulting in substantial and others in only trifling amounts of damage. The result of some of these breaches is that the actual damage will exceed the penalty. It is unlikely that these cases establish the power of a party to opt for or against the penalty and the possibility of no limit on the amount of damages recoverable, for two reasons. First, the judgment of Bailhache J in *Wall* (much relied upon in *Watts, Watts & Co Ltd v Mitsui & Co Ltd*)[102] relies upon a very old case modified by the application of a now defunct Act.[103] Not only is the ratio in *Watts, Watts* easily distinguishable, it is open to question whether it now has any application at all. Second, both *Wall* and *Watts, Watts* were concerned with charterparties and with a very common type of penalty clause in contracts of that kind. Indeed, the main thrust of argument was whether a slight amendment which had been made to the clause was sufficient to change it into an enforceable provision for liquidated damages. There is

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[98] *Diestal v Stevenson* [1906] 2 KB 345, at first sight appears to be authority that the penal sum is not a ceiling on what is recoverable, but in that case the judge used the words 'it is agreed'; a clear indication that he was not deciding the matter but simply recording what the parties had already agreed. In the event, the sum was held to be liquidated damages, despite being referred to as a penalty, and the judge had no further need to refer to the point.

[99] (1768) 4 Burr 2225 at 2228.

[100] *Wall v Rederiaktiebolaget Luggude* [1915] 3 KB 66 at 72 per Bailhache J, a judgment which was affirmed in glowing terms by the House of Lords in *Watts, Watts & Co Ltd v Mitsui & Co Ltd* [1917] All ER 501.

[101] *Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd* [1915] All ER 742 per Lord Dunedin.

[102] [1917] All ER 501.

[103] Statute of William III 1697, 8 & 9 Will 3 c 11, repealed by the Statute Law Revision Act 1948.

no such tradition regarding a penalty clause in common form in the building industry. More recently, it has been said:

> 'Where the court refuses to enforce a "penalty clause" of this nature, the injured party is relegated to his right to claim that **lesser measure of damages** to which he would have been entitled at common law for the breach actually committed if there had been no penalty clause in the contract.'[104] (emphasis added)

and later, in the same case:

> 'Again, it is by no means clear that "penalty clauses" are simply void, like covenants in unreasonable restraints of trade. There are dicta either way, and in *Cellulose Acetate Silk Co Ltd v Widnes Foundry (1925) Ltd* [105] Lord Atkin expressly left open the question whether a penalty clause in a contract, which fixed a single sum as payable on breach of a number of different terms of the contract, some of which breaches may occasion only trifling damage but others damage greater than the stipulated sum, would be treated as imposing a limit on the damages recoverable in an action for a breach in respect of which it operated to reduce the damages which would otherwise be recoverable at common law.'[106]

What Lord Atkin actually said was:

> 'I desire to leave open the question whether, where a penalty is plainly less in amount than the prospective damages, there is any legal objection to suing on it, or in a suitable case ignoring it and suing for damages.'[107]

Lord Atkin in refusing to pass an opinion on the principle held in *Wall* and affirmed in *Watts, Watts*, appeared to be indicating that the House of Lords was disengaging itself from its earlier decision by refusing to apply it in general terms to all penal sums.

3.12 Maximum recovery if liquidated damages do not apply

Where the amount inserted in the contract is held to be a penalty, invariably such a holding will be against the wishes of the employer who has inserted the sum in the hope and perhaps expectation of getting it. However, where liquidated damages are held not to apply, that is usually because the employer has taken, or omitted to take, some action which destroys the right to such damages; possibly in an effort to recover greater damages.

In *The Rapid Building Group Ltd v Ealing Family Housing Association Ltd*,[108] the court affirmed the judge's holding that it was not open to the defendants to counterclaim the amount of liquidated damages. This was because they had been partly responsible for part of the delay in achieving the completion date. Since there was not adequate provision to allow the defendant to extend time for that particular

[104] *Robophone Facilities v Blank* [1966] 3 All ER 128 at 142 per Diplock LJ considering whether a sum was penal.
[105] [1932] All ER 567 at 570.
[106] *Robophone Facilities v Blank* [1966] 3 All ER 128 at 142.
[107] *Cellulose Acetate Silk Co Ltd v Widnes Foundry* (1925) Ltd [1933] AC 20 at 570.
[108] (1984) 1 Con LR 1.

reason, the liquidated damages clause did not apply.[109] The court accepted that the defendant could pursue a claim for unliquidated damages, but it refused to be drawn on the proposition that the claim would have a ceiling equal to the amount of liquidated damages. However, the Supreme Court of Canada has said:

> 'If the actual loss turns out to exceed the penalty, the normal rules of enforcement of contract should apply to allow recovery of only the agreed sum. The party imposing the penalty should not be able to obtain the benefit of whatever intimidating force the penalty clause may have in inducing performance, and then ignore the clause when it turns out to be to his advantage to do so. A penalty clause should function as a limitation on the damages recoverable, while still be ineffective to increase damages above the actual loss sustained when such loss is less than the stipulated amount.'[110]

This statement probably represents the modern approach to this problem where the stipulated sum is held to be a penalty rather than liquidated damages, but it is not clear whether it necessarily represents the position following the failure of the liquidated damages clause for any reason. Where parties have agreed a figure to represent estimated damages and the mechanism for putting their wishes into effect has been contractually disabled, can it be said that recovery of whatever damages can be proven should be allowed, even if they exceed the liquidated damages figure? A penalty is always a sum which is extravagant in relation to the damages likely to be incurred, but liquidated damages can operate as a limitation on damages.[111]

In considering the question, it must be remembered that in the case of liquidated damages in a building contract, no default on the part of the contractor can prevent the application of the clause. The clause can only fail as a result of a default on the part of an employer. A contractor who enters into a contract with an employer which includes a relatively small sum for liquidated damages will have a valuable advantage. The employer will be equally and oppositely disadvantaged, but both parties will have agreed on the arrangement as part of the distribution of risk inherent in that particular contract.

Part of the employer's implied obligations will be not to prevent the contractor from due performance.[112] Among the employer's express obligations will be, personally or through the architect, to grant proper extensions of time at the right time., It is possible for an employer, who is so minded, to disable the liquidated damages clause by causing the architect to fail to grant an extension of time in appropriate circumstances and then the employer would be entitled to claim whatever amount of unliquidated damages could be proven.[113] If the sum stipulated in the contract is not a ceiling on what can be claimed in those circumstances, it would be open to the employer to effectively alter the distribution of risk and, as a result of the employer's own default, be entitled to a greater sum in damages than if the employer's part of the bargain had been properly performed. Purely on the principle that a party cannot profit by its own contractual breach to the detriment of the other party, there is a

[109] *Peak Construction (Liverpool) Ltd v McKinney Foundations Ltd* (1970) 1 BLR 114.
[110] *Lorna P Elsley v J G Collins Insurance Agencies Ltd* (1978) 4 Const LJ 318 at 320 per Dickson J.
[111] *Cellulose Acetate Silk Co Ltd v Widnes Foundry* (1925) Ltd [1932] All ER 567.
[112] *London Borough of Merton v Stanley Hugh Leach Ltd* (1985) 32 BLR 51.
[113] *Peak Construction (Liverpool) Ltd v McKinney Foundations Ltd* (1970) 1 BLR 114.

strong argument that the liquidated damages sum must be a ceiling on recovery.[114] On this analysis, the argument for a ceiling on recoverable damages is probably stronger where the liquidated damages are irrecoverable due to the employer's default than because they are held to be a penalty.

3.13 Defences to liquidated damages in building contracts

Where a sum has been stipulated as liquidated damages in a building contract, it is usual for the sum to be deducted by the employer from monies owing to the contractor in the event of a breach to which the liquidated damages relate. The following defences may be advanced by the contractor in order to avoid payment:

3.13.1 The stipulated sum is actually a penalty

The grounds on which a contractor may put forward this contention are noted in section 3.2 of this chapter.

3.13.2 Time is at large

If the parties intend that liquidated damages are to be payable if the contractor fails to complete the Works, a date for completion must be stipulated in the contract. That is because there must be a definite date from which to calculate liquidated damages.[115] There is an implied term in every contract that the employer will do all that is reasonably necessary to co-operate with the contractor[116] and that the employer will not prevent the contractor from performing it.[117] In the context of a building contract, the employer's co-operation probably extends to little more than that the employer should ensure that the contractor has all necessary drawings and instructions at the right time to enable it to carry out the work. In this respect, the employer also has a duty to ensure that any architect appointed properly carries out architectural duties.[118]

Alongside the implied term of co-operation, there must be in every contract an implied term that neither party will do anything to hinder or delay performance by the other.[119] Such a term was upheld as generally applicable to building contracts in *London Borough of Merton v Stanley Hugh Leach Ltd.*[120] An employer who does hinder the contractor can no longer insist that the contractor finishes its work by the contractual date for completion. This principle has the weight of judicial authority behind it. In *Holme v Guppy* it was said:

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[114] *Alghussein Establishment v Eton College* [1988] 1 WLR 587.
[115] *Miller v London County Council* (1934) 50 TLR 479.
[116] *Luxor (Eastbourne) Ltd v Cooper* [1941] 1 All ER 33.
[117] *Cory Ltd v City of London Corporation* [1951] 2 All ER 33.
[118] *Perini Corporation v Commonwealth of Australia* (1969) 12 BLR 82.
[119] *Barque Quilpué Ltd v Brown* [1904] 2 KB 261.
[120] (1985) 32 BLR 51.

> '. . . and there are clear authorities, that if the party be prevented, by the refusal of the other contracting party, from completing the contract within the time limited, he is not liable in law for the default.'[121]

That was a case where a builder agreed to construct a brewery in four and a half months subject to liquidated damages of £40 per week. Completion was late due to the default of the employer in failing to give possession of the site on the due date. It was said in a New Zealand judgment:

> '. . . no person can take advantage of the non-fulfilment of a condition the performance of which has been hindered by himself; that a party is exonerated from the performance of a contract when the performance is rendered impossible by the wrongful act of the other contracting party; or more emotively, that a party cannot take advantage of his own wrong.'[122]

It is clearly not an immutable rule; it will depend on circumstances. For example, where a contractor has undertaken to carry out works including any alterations or additions which the employer might chose to make it can be bound to its undertaking. In *Jones v St John's College Oxford*[123] it was said:

> '. . . the plaintiffs undertake not only to do by a given time the works which were specified, and which they had the opportunity therefore of forming their own judgment upon, but they also undertake to do the alterations, that is to say, such alterations as are contemplated by the contract, within the time originally prescribed for the performance of the works.'[124]

It is not clear whether the judge was referred to *Jones* in *Wells v Army and Navy Co-operative Society Ltd*[125] where the contractor was not liable to pay 'penalties' on account of exceeding the contract period. The key facts seem to have been that although the contract provided for the contractor to complete by the due date notwithstanding variations, strikes and weather conditions and subject only to any extension of time which the employer may, but was not obliged to grant, it was not wide enough to cover the employer's own defaults. In general, the courts adopt the approach that 'it is not to be inferred that the one party meant to bind himself so very stringently, unless it is so stated.'[126] In *Dodd v Churton*[127] it was held that an employer who prevents the contractor completing within the stipulated time cannot recover liquidated damages. *Jones* was distinguished, because although there was a term which empowered the ordering of additional work and this was done, the contractor had not agreed to complete within the original period despite the ordering of additional work. Very clear words will be needed in order to bind a contractor to a completion date if the employer is the cause of the delay. This principle is now well established.[128]

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[121] (1938) 3 M & W 387.
[122] *Canterbury Pipelines Ltd v Christchurch Drainage Board* (1979) 16 BLR 76.
[123] (1870) LR 6 QB 115.
[124] (1870) LR 6 QB 115 at 123 per Mellor J.
[125] (1902) 86 LT 764.
[126] *Roberts v Bury Commissioners* (1870) LR 5 CP 310 at 327 per Kelly CB.
[127] [1897] 1 QB 562.
[128] *Percy Bilton Ltd v Greater London Council* (1982) 20 BLR 1.

In the absence of any agreed contractual mechanism for fixing a new date for completion, no such new date can be fixed and the contractor's duty then will be to complete the Works within a reasonable time.[129] In such circumstances time is said to be 'at large'. In practice, very few building contracts are without a clause enabling the employer or the employer's agent to fix a new completion date after the employer has caused delay to the contractor's progress. All standard forms have clauses permitting the extension of time although not all of the terms are entirely satisfactory. Even where a building contract contains terms providing for extension of the contract period, time may yet become at large either, because the terms do not properly provide for the delaying event or, because the architect has not operated the terms properly. Extension of time clauses should be drafted so as to include all delays which may be the responsibility of the employer. Then, if the employer, either personally or through the agency of his architect, hinders the contractor in a way which would otherwise render the date for completion ineffective, the architect will have the power to fix a new date for completion and thus preserve the employer's right to deduct liquidated damages. The position was set out by Salmon LJ in *Peak Construction (Liverpool) Ltd v McKinney Foundations Ltd*:

> 'The liquidated damages and extension of time clauses in printed forms of contract must be construed strictly *contra proferentem.* If the employer wishes to recover liquidated damages for failure by the contractors to complete on time in spite of the fact that some of the delay is due to the employer's own fault or breach of contract, then the extension of time clause should provide, expressly or by necessary inference, for an extension on account of such a fault or breach on the part of the employer. I am unable to spell any such provision out of . . . the contract [clause] in the present case.'[130]

In that case, the extension of time clause, after referring to certain events of a neutral character, i.e. they could not be said to be the fault of either contractor or employer, made reference to '. . . or other unavoidable circumstances . . . '. This was the phrase on which the employer relied, but 'delay due to the employer cannot be said to have been an unavoidable circumstance to anyone save the contractor.'[131] A similar phrase is 'other causes beyond the control of the contractor'. It has been held that these words 'ought to be construed with reference to the preceding causes of delay, and ought not to receive such an extension as would make the defendants judges in respect of their own defaults'.[132] This view was noted with approval in *Perini Pacific v Greater Vancouver Sewerage and Drainage District*.[133] The extension of time clause 2.7 in MW (2.8 in MWD) may suffer from a similar defect, but it has not been tested in the courts, probably because the relatively low value of contracts entered into under this form of contract discourages expensive litigation.

This clause can be contrasted with ACA 3 clause 11.5 Alternative 2. The material part of this clause (e) is very clear:

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[129] *Wells v Army & Navy Co-operative Society Ltd* (1902) 86 LT 764.
[130] (1970) 1 BLR 111 at 121.
[131] (1970) 1 BLR 111 at 126 per Edmund Davies LJ.
[132] *Wells v Army & Navy Co-operative Society Ltd* (1902) 86 LT 764 at 765 per Wright J.
[133] (1966) 57 DLR (2d) 307 at 321 per Bull JA.

'(e) any act, instruction, default or omission of the Employer, or of the Architect on his behalf, whether authorised by or in breach of this Agreement'.

The JCT series of contracts (other than MW and MWD) favour a list of events giving grounds for extension of time. Because the architect's power to give an extension of time is circumscribed by the listed events, there is a danger that the employer may delay the Works in a way which does not fall under one of the events. In such a case, time would be at large. For example, the 1963 edition of the JCT Standard Form did not include power for the architect to extend time for the employer's failure to give the contractor possession of the site on the due date. An employer's failure in this respect resulted in time becoming at large and the contractor's obligations being to complete the works within a reasonable time. This although it was acknowledged by the court that the contractor had himself subsequently contributed to the delay.[134] It used to be doubted whether or not, unless the contract specifically so provided the architect had the power to give an extension of time if the employer caused further delay when the contractor was already in delay through its own fault. But the court has confirmed that, certainly under the JCT standard form, the architect has such power.[135] Where the extension of time clauses are properly drafted, but the architect operates them incorrectly, time will become at large. An example of this would be if the architect was late in delivering necessary drawing information to the contractor, but failed to give any extension of time. This is a clear case of the architect not taking advantage of the available mechanism. Another example is where the contract provision sets out a timetable within which the architect must operate to give an extension of time. An architect who fails to observe the timetable may lose the power to give an extension and time will become at large.

3.13.3 Time has been extended

If the contractor fails to complete by the contract date for completion, it can escape liquidated damages if the architect gives an extension of time and/or fixes a new date for completion. The architect must strictly comply with the terms of the contract in fixing the new date.[136]

3.13.4 Waiver

This is the relinquishment of a right or remedy. If one party indicates to the other, either by plain words or by conduct, that it intends to forego a right it may not thereafter insist upon that right if circumstances change. No consideration is required and if consideration is present, the situation is probably one of variation. Because there is no consideration, it is possible for the waiver to be withdrawn on the giving of suitable notice, but the waiver will be permanent if the party receiving the

[134] *Rapid Building Group Ltd v Ealing Family Housing Association Ltd* (1984) 1 Con LR 1.
[135] *Balfour Beatty Ltd v Chestermount Properties Ltd* (1993) 62 BLR 1.
[136] *Peak Construction (Liverpool) Ltd v McKinney Foundations Ltd* (1976) 1 BLR 111.

waiver is led to believe that the waived right will never be enforced.[137] Waiver is closely related to estoppel, but there is no requirement for a party to alter its position to its detriment in order to constitute waiver. The employer may lead the contractor to believe that although liquidated damages have been stated in the contract, they will never be enforced, or the employer may say that the date for completion will not be enforced. In either case, if the contractor acts on that basis, it is doubtful whether such a waiver could be withdrawn.[138] In such an instance the true position may be one of promissory estoppel, because the contractor will have acted to its detriment upon a promise that the employer will not enforce its contractual right.

Normally, this kind of promise will not be permanent and the estopped party can terminate the arrangement by suitable notice: *Central London Property Trust Ltd v High Trees House Ltd.*[139] In that case, the promise not to demand a full rent could be withdrawn and the tenant obliged to pay future rents at the full rent without any real detrimental effect on the tenant. However, in the case of a promise not to enforce liquidated damages in a building contract, once the contractor has slowed its progress, it has performed an act in reliance of the promise, the consequences of which cannot be altered without further expenditure on the part of the contractor, if at all. There are two basic possibilities:

(a) The contractor is, say, ten weeks from contract completion date when the employer promises not to enforce liquidated damages. The contractor, who was on target to complete on time using an optimum amount of labour, relaxes its progress, but the employer withdraws its promise five weeks before completion date when the contractor still has seven weeks work to carry out, working at the reduced rate of progress. If the contractor can complete on time, it will have expended more money than it originally expected, because it is less efficient to increase labour beyond an optimum point. If, despite its efforts, it finishes after the completion date, it will be liable to pay liquidated damages which, but for reliance upon the promise, would not have been incurred.
(b) The facts as above except that the employer withdraws its promise two weeks after the contract completion date, but when the contractor still has three more weeks work to carry out working at the reduced rate. The contractor can do nothing but attempt to reduce the time to complete the work. Even if, by analogy with *High Trees,* the contractor is not liable to pay liquidated damages for the two weeks between the due date and the employer's withdrawal, there is nothing it can do to prevent a liability for up to three weeks liquidated damages from the time of withdrawal until actual completion.

It is doubtful that the employer would be entitled to terminate the arrangement once the contractor has taken any significant steps in reliance on it, such as paying its sub-contractors in full without deducting any damages for their failure to complete in time.[140]

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[137] *Brikom Investments Ltd v Carr* (1979) 2 All ER 753.
[138] *Charles Rickards v Oppenheim* [1950] 1 KB 616.
[139] (1947) KB 130.
[140] *London Borough of Lewisham v Shepherd Hill Civil Engineering* 30 July 2001, unreported.

3.13.5 Failure to observe the contract terms

Many of the JCT series of contracts set out a detailed procedure for dealing with the payment of liquidated damages. It is widely considered that there are two conditions precedent to the deduction of such damages by the employer: a certificate of the architect that the contractor has not completed the works by the contract date for completion and a written requirement by the employer. This view received support from the decision in *A Bell & Son (Paddington) Ltd v CBF Residential Care & Housing Association Ltd* considering JCT 80:

> '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 24.2.1 were conditions precedent to the recovery of them under the latter part of Clause 24.2.1.'[141]

Doubt was thrown upon the words in *Jarvis Brent Ltd v Rowlinson Constructions Ltd* when the same form of contract was considered.[142] It was held that although the architect's certificate under clause 24 was a condition precedent, there was no condition precedent that the employer's requirement must be in writing in spite of the clear words of the clause '. . . as the Employer may require in writing. . .' . The judge noted that it was 'agreed' that the passage in *Bell* was *obiter*. It seems that he did not consider himself called upon to decide the point. He went on to say:

> 'But I am satisfied 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 certificates as liquidated and ascertained damages under the contract.'[143]

The question of whether the two stipulations were conditions precedent was part of the *ratio* of the *Bell* case. There, the judge had reminded himself that a contract was 'to be construed according to the strict, plain, common meaning of the words themselves'[144] and that whether the plaintiffs succeeded depended on the proper construction of clause 24. A subsequent case appeared to strengthen that view: *Holloway Holdings Ltd v Archway Business Centre Ltd*.[145] There, considering IFC 84 clause 2.7 (terms to the same effect as the terms considered in *Bell* and *Jarvis*) the court held:

> 'For Archway to be able to deduct liquidated damages there must be a certificate from the Architect and a written request to Holloway from Archway… In this context, I consider that a strict approach is appropriate (even if I have any

[141] (1989) 46 BLR 102 at 107 per Judge Newey.
[142] (1990) 6 Const LJ 292.
[143] (1990) 6 Const LJ 292 at 297 per Judge Fox-Andrews.
[144] *Shore v Wilson* (1842) 9 C & F 355 quoted in *A Bell & Son (Paddington) Ltd v CBF Residential Care and Housing Association Ltd* (1989) 46 BLR 102 at 107 per Judge Newey.
[145] (1991) ORB No 861 unreported.

discretion in the matter) as I do not want to encourage the cavalier attitude that Archway seems to have towards its contractual obligations.'[146]

A case which was not referred to in any of these judgments was *Ferrum GmbH v Owners of the Mozart.*[147] The court held that 'due notice' was such notice as was appropriate in the circumstances. The court added that 'the law never compelled the doing of that which was useless and unnecessary'. It may have been this principle which the judge had in mind when coming to a decision in the *Jarvis Brent* case.

The weight of authority and the clear words of the contract favour treating both the architect's certificate and the employer's written requirement as conditions precedent.

3.13.6 The contract is terminated

In general, it appears that if a contract is terminated, the obligations of both parties under the contract are at an end in so far as future performance is concerned.[148] This seems to be perfectly in accordance with good sense, because if the Works are completed by another contractor, the original contractor can have no control over the completion. That is not to say that a party will avoid the payment of damages accrued up to the time of termination.[149]

The decision in *Re Yeardon Waterworks Co & Wright* suggests that the courts will support a specific term in a contract which provides that in the event of termination of the employment of a contractor and the completion by another, damages could be deducted until the Works are completed.[150] In that case, however, the Works were completed by the guarantor of the contractor which was probably the deciding factor. The JCT series of contracts provide for termination of the contractor's employment, following which the employer may engage another contractor to enter site and complete the Works. Such a clause was held to be incompatible with the right to liquidated damages in *British Glanzstoff Manufacturing Co Ltd v General Accident Fire & Life Assurance Corporation Ltd*.[151] Where a contractor has left the site, wrongly thinking that it has completed the Works, it seems it will be liable for liquidated damages until the work has in fact been completed by a replacement contractor.[152] The precise wording of the clause in the contract will be the deciding factor. In the New Zealand case of *Baylis v Mayor of the City of Wellington* liquidated damages were held to be deductible after termination, because the clause specifically excluded entitlement during the time taken by the employer to secure a replacement contractor.[153]

In *Re White*,[154] the electric lighting contract contained what was held to be a liquidated damages clause. The court remarked that there was a clause in the contract

[146] (1991) ORB No 861 unreported at 12 per Tackaberry J.
[147] (1984) TLR 2 November 1984.
[148] *Suisse Atlantique Societé d'Armement SA v N V Rotterdamsche Kolen Centrale* [1966] 2 All ER 61.
[149] *Ex parte Sir W Harte Dyke. In re Morrish* (1882) 22 Ch D 410 CA.
[150] (1895) 72 LT 832.
[151] [1913] AC 143.
[152] *Williamson v Murdoch* [1912] WAR 54.
[153] (1886) 4 NZLR 84.
[154] (1901) 17 TLR 461.

which gave the engineer power, if necessary, to employ other contractors to complete the Works, and provided that the defaulting contractor should be liable for the loss so incurred without prejudice to its obligation to pay the liquidated damages under the contract. It is not clear from the report whether the employer was seeking liquidated damages beyond the date of termination. However, the employer does not appear to have claimed anything other than liquidated damages, despite the words of the contract which appear to give the employer the right to claim liquidated damages for breach of obligation to complete on time until the date of actual completion together with all the additional costs associated with completion by another contractor.

The effect of termination on the right to recover damages was considered in *Photo Production Ltd v Securicor Transport Ltd.*[155] Speaking of *Harbutt's Plasticine Ltd v Wayne Tank and Pump Co Ltd*[156] it was said:

> 'that when in the context of a breach of contract one speaks of "termination" what is meant is no more than that the innocent party or, in some cases, both parties are excused from further performance. Damages, in such cases, are then claimed under the contract, so that what reason in principle can there be for disregarding what the contract itself says about damages, whether it "liquidates" them, or limits them, or excludes them?'[157]

This seems to be a clear reinforcement of the view that there can be no continuing liability to pay liquidated damages, but damages already accrued, however, are recoverable. Standard forms of building contract normally state the grounds on which either party may terminate its employment under the contract. In a recent case dealing with a contract incorporating the JCT Minor Works Building Contract with contractor's design (MWD), the court appears to have driven a coach and horses through previous decisions on this point. The court said:

> 'If practical completion was not achieved when the defendant suspended the works in January 2008 then, given that it is common ground that the defendant never returned to site, it must follow that the defendant never achieved practical completion of the works. Practical completion of the works was only achieved once the remedial contractor, Voytex, had completed the outstanding works. That was not until 17th May 2008.It is not suggested that the claimants delayed unreasonably in engaging a replacement contractor. In the absence of any other contender, therefore, 17Th May must be the date of practical completion.
>
> Accordingly, on the analysis set out above, it seems to me clear that, after 3rd November 2007, the defendant was in culpable delay. That period of culpable delay extended beyond the defendant's suspension of the works in mid January 2008 and could not be said to come to an end until 17th May 2008 when the works finally achieved practical completion . . . .
>
> I reject the suggestion that the defendant's liability to pay liquidated damages somehow came to an end when his employment under the contract was terminated. There is no such provision in the contract. Any such term would reward

[155] [1980] 1 All ER 556 HL.
[156] [1970] 1 All ER 225 CA.
[157] [1980] 1 All ER 556 HL at 562 per Lord Wilberforce.

the defendant for his own default. Take the example of a contractor who has wholly failed to comply with the contract, is in considerable delay and is facing a notice of termination. The defendant's case would mean that such a contractor was only liable to pay liquidated damages for delay before the decision was taken to terminate, thereby penalising the employer for trying to get the works completed by another contractor and rewarding the contractor for sitting on his hands and failing to carry out the works in accordance with the programme. If the defendant was right, the contractor would be better off not coming back on site to carry out the works because, if he refused to do so, the contract would then be terminated and his liability to pay liquidated damages would automatically come to an end. That would not be a commonsense interpretation of this (or any) construction contract.

Accordingly, as a matter of principle, I reject the submission that the defendant's liability to pay liquidated damages came to an end when the employment was terminated.'[158]

Although it is tempting to follow this reasoning and it seems perfectly logical, it is thought unlikely that this view will prevail for the following reasons:

- During the trial, the defendant contractor was not present or represented. It seems that no legal arguments were presented on behalf of the defendant. In particular, the court does not appear to have been referred to the earlier cases from higher authority on this point noted above.
- Moreover, the court decided that practical completion was not achieved by the defendant and that it was not achieved until after a new contractor had been appointed. Clearly, once termination had taken place, practical completion could never take place under the original contract. The practical completion to which the court refers was practical completion achieved by a new contractor under a new contract. Therefore, it seems incorrect to refer to liquidated damages calculated under one contract to the date of practical completion of an entirely different contract albeit aimed at completing the same Works. Even on MWD's own terms, clause 2.9 refers to the calculation of liquidated damages between the date for completion and the date of practical completion in the same contract. Certification of practical completion is dealt with by clause 2.10 and it is clear that it is practical completion under the contract which is relevant. Therefore, since practical completion could never have been certified under the contract, because the contractor's employment had been terminated, either liquidated damages continued to accrue for an infinite period of time (which is obviously nonsensical) or the damages stopped accruing at the point at which the employer made it impossible for the original contractor to complete the Works.
- Although only briefly touched on by the judge, it seems that the fact that there was no suggestion of unreasonable delay in appointing the replacement contractor was a factor in the decision. Without that qualification, it would follow from his decision that the amount of liquidated damages chargeable is under the control of the employer who can decide when to put completion work in place.

[158] *Hall and Shivers v Van der Heiden (No 2)* [2010] EWHC 586 (TCC) at paragraphs 45, 46, 76 and 77 per Coulson J.

Although some commentators are already saying that, as a result of this case, contracts should be amended to expressly state that liquidated damages are to cease on termination, it is clear that current JCT contracts, if properly interpreted, already make the position clear.

Many of the grounds for termination under the provisions of the contract are not breaches which would entitle the employer to terminate save for the express provision. It is thought that an employer who terminated using the contract provisions is restricted to recovering the amounts stipulated in the contract.[159] Current building contracts do not appear to allow the continued deduction of liquidated damages after termination.

3.14 Bonus clauses

Few contracts make provision for bonus clauses as a standard option.[160] Bonus clauses are usually written into contracts if the employer wishes to provide an incentive for the contractor to finish early. They provide for the payment of a sum of money for every day or week difference between the date the contractor achieves practical completion, or the equivalent, and the contract completion date. It is the reverse of a liquidated damages provision. Bonus clauses need have no relation to liquidated damages. They may be greater or less than the liquidated damages sum or there may be no bonus clause at all. It is *not* true that where there is a liquidated damages clause there must also be a bonus clause for the same amount. Exactly how a bonus clause is structured depends on the requirements of the employer and the ingenuity of the draftsman. Commonly, such a clause may provide for a relatively modest payment if the contract completion date is beaten by a few days stepping up to significantly larger sums as the contractor succeeds in achieving earlier completion dates.

A disagreeable feature of bonus clauses is that lost opportunity to achieve a bonus will feature in many claims relating to contracts where a bonus is on offer. It is worthwhile considering the effect of a bonus clause on such clauses as 2.11 and 2.12 of SBC. The architect who, put broadly, provides information to the contractor in accordance with the information release schedule or otherwise in such time that the contractor is able to complete the Works by the contract date for completion will usually comply with clauses 2.11 and 2.12. However, if a bonus clause is inserted, the contractor will doubtless call for information much earlier than usual on the basis that it needs it earlier if it is to earn the bonus. It will be difficult to resist this argument and clauses 2.11 and 2.12 of SBC and clauses 2.10 and 2.11 of IC and ICD would require redrafting accordingly. Indeed, it is difficult to see how the information release schedule can sit happily beside a bonus clause or indeed at all.

What amounts to a bonus clause may perhaps arise without the parties being entirely aware of it. In *John Barker Construction Ltd v London Portman Hotels Ltd*,[161] the parties entered into an acceleration agreement. Among other things, the

[159] *Thomas Feather & Co (Bradford) Ltd v Keighley Corporation* (1953) 52 LGR 30.
[160] A notable exception is the Engineering and Construction Contract (NEC), see Chapter 18.
[161] (1996) 50 Con LR 43.

agreement stipulated that the contractor would be paid additional sums of £50,000 to be included in the valuation on 20 July 1994, £20,000 to be included in the valuation on 3 August 1994 and £20,000 on completion on 26 August 1994. Considering the final payment of £20,000 on 26 August 1994, Mr Recorder Toulson said:

> 'I conclude that the £20,000 was agreed to be a performance related payment if the plaintiffs completed by the 26 August 1994 . . .
>
> It was also an express term of the acceleration agreement that the defendants would supply the plaintiffs with all outstanding information by the end of 12 July 1994, and I accept that there were implied non-hindrance terms as pleaded in paragraph 7 of the re-amended statement of claim.
>
> By reason of the numerous changes made after the acceleration agreement the defendants were in breach of those implied terms, if not also of the express term. The latter point turns on whether the express duty was conditional upon receipt of a specific request for information from the plaintiffs. I doubt that it was, but the point is academic.
>
> It is impossible to tell whether, as a matter of probability, the plaintiffs would or would not have finished by 26 August 1994, but for those changes. They would have had a reasonable opportunity of doing so, but they could easily have failed for all manner of reasons. In those circumstances I would hold that the plaintiffs are entitled to damages for loss of that chance equal to 50 per cent of the agreed performance bonus, or £10,000.[162]

Although based on a specially worded acceleration agreement, nevertheless, this part of the judgment gives useful guidance on the way in which the courts may decide whether and to what extent a contractor has been deprived of the opportunity to earn a bonus by the actions or defaults of the employer and architect. In this instance the judge took a robust, if somewhat rough and ready, approach.

[162] (1996) 50 Con LR 43 at 69 per Mr Recorder Toulson.