LIQUIDATED DAMAGES : THE HIDDEN DANGERS

Presented by

Mohan R Pillay & Tay Peng Cheng

WONG PARTNERSHIP

CONTACT DETAILS

WONGPARTNERSHIP

80 Raffles Place

#58-01 UOB Plaza 1

Singapore 048628

Mohan R Pillay

DID : 6416-8118

Email : mrp@wongpartnership.com.sg

Tay Peng Cheng

DID : 6416-8121

Email : tpc@wongpartnership.com.sg

All rights reserved ©

CONTENTS

- What are Liquidated Damages
- Purpose of Liquidated Damages
- Key Points in Considering Liquidated Damages
- Liquidated damages and time of completion
- Are Losses in Excess of Liquidated Damages Recoverable

What Are Liquidated Damages

- Fixed amount which is to be paid in the event of breach.
- In some cases the amount will apply to all breaches, in others only to particular breaches.
- In some cases it will apply to breach by either party, in others only to breach by one particular party.
- Sometimes different sums may be stipulated for different breaches, whether by one or both parties.
- Whether the agreed sum is recoverable from the party in breach depends on whether it constitutes liquidated damages or a penalty.
- Penalties are unenforceable whereas liquidated damages are recoverable.

All rights reserved ©

Purpose of Liquidated Damages

- To enable the parties to be able to agree beforehand the damage recoverable for a breach of contract.
- Mutually benefiting clause to both the employer and the contractor as it will be to their advantage that they should know with reasonable degree of certainty the extent of their abilities and risks which they run as a result of entering into the contract.
- For the employer, the stipulation for liquidated damages will enable him to know the extent to which he is protected in the event of the contractor failing to perform his obligations.
- For the contractor, the clause limits his exposure to claims by the employer.

Purpose of Liquidated Damages

When is a liquidated damages clause suitable

- Difficulty in quantifying loss
- Where certainty is required

Advantages and Disadvantages

- Enables the contractor when quoting for a contract to take account of the possible liability which he may be under before determining the price he should quote.
- Loss need not be proved
- Usually an exhaustive remedy and in an event that a condition precedent to the liquidated damages regime is not satisfied, the employer may be left without a remedy.

All rights reserved ©

Key Points in Considering Liquidated Damages

- Genuine pre-estimate of loss
  - Purpose : mainly to avoid the complexity of proving the extent of actual damages incurred in an action for breach.
  - This differs from a penalty in which the stipulated sum is fixed in *terrorem* of the other party and is characterised by being extravagant and unconscionable.
- Enforceability
  - Dependant on whether a liquidated damages provision or a penalty.
  - Burden of proving that the clause is a penalty clause lies on the party challenging the clause.
  - *Dunlop Pneumatic Tyre Co. v. New Garage and Motor Co.*

- The wording of both parties is important in inferring their intentions. But this is not conclusive.
- Essence of penalty is payment of money stipulated as "in terrorem" of the party in breach; while essence of Liquidated Damages is a genuine covenanted pre-estimate of damage.
- Question of construction to be decided upon the terms and circumstances of each contract; judged as at the time when the contract was entered into.
- Helpful tests :

All rights reserved ©

- It will be held to be a penalty if the sum stipulated for is extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from the breach.
- 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.
- Presumption 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 several events, some of which may occasion serious and other but trifling damages.
- 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.

- Strict compliance with condition precedents
  - The usual condition precedent will require the architect or the engineer or SO to certify in writing that the works have been delayed in order for the liquidated damages to be imposed.
  - The exact conditions that need to be satisfied in order to constitute valid certification depend on the wording of the individual liquidated damages provisions eg clause 24(2) SIA conditions.
    - *"24(2) Upon receipt of Delay Certificate the Employer shall be entitled to recover from the Contractor liquidated damages calculated at the rate stated in the Appendix to the Conditions from the date of default certified by the Architect for the period during which the Works shall remain incomplete..."*
  - Any failure to comply with any of these conditions will render any deduction of liquidated damages unlawful and the contractor will be able to sue for their return.
  - *Amalgamated Building Contractors v Waltham Holy Cross UDC* :

All rights reserved ©

- *(17) If the contractor fails to complete the works by the date stated in the appendix to these conditions ... and the architect certifies in writing that in his opinion the same ought reasonably so to have been completed, the contractor shall pay or allow the employer a sum calculated at the rate said in the said appendix as liquidated and ascertained damages..."*

- It was held by the English Court of Appeal that such a certificate under clause 17 was a condition precedent to claiming liquidated damages.
- *A Bell & Son (Paddington) Ltd v CBF Residential Care and Housing Association* :
  - *"(24.1) If the Contractor fails to complete the works by the Completion Date then the Architect shall issue a certificate to that effect.*
  - *"(24.2.1) Subject to the issue of a certificate under Clause 24.1 the Contractor shall... pay or allow to the Employer the whole or such part as may be specified in writing by the Employer of a sum calculated at the rate stated in the Appendix as liquidated and ascertained damages..."*
  - *Court held that "there can be no doubt that a certificate of failure to complete given under clause 24.1... were conditions precedent to the making of deductions on the account of liquidated damages or recovery of them under the latter part of clause 24.2.1"*

- Rationale : Certainty
- Certificates should be clear and unambiguous.
- *Token Construction Co Ltd v Charlton Estates Ltd :*
  - *"(16) If the Contractor fails to complete the Works by the date stated in Appendix C to this Contract.... and the Architect certifies in writing that in his opinion the same ought reasonably so to have been completed , the Contractor shall pay or allow to the employer a sum calculated at the rate stated in Appendix C as Liquidated and Ascertained Damages for the period during which the same Works shall so remain or have remained incomplete ..."*
- Arising from this clause :
  - The architect must 'certify' in writing. Although there was no set form of certificate provided, it must clearly appear that the document relied upon is the physical expression of a certifying process.
  - The architect must form an opinion as to whether the 'works ought reasonably to have been completed' by a specified date.
- *Savage Brother Limited v Shillington (Heating and Plumbing Limited)* :

All rights reserved ©

- *"8(a) ... provided that the Contractor shall not be entitled to claim any loss or damage under this clause unless the architect shall have issued to the contractor (with a duplicate copy to the sub-contractor) a certificate in writing stating that in his opinion the sub-contractor works or the relevant section thereof ought reasonably to have been completed within the specified periods or within any extended period or periods as the case may be."*

- Court held :
  - If the proviso to clause 8(a) is to be complied with, the architect somehow must express his opinion that the respondent's sub-contract works ought reasonably to have been completed within the specified period or within the extended period or periods.
  - The language used by the architect is so ambiguous that I find it difficult even to infer from it that the architect did hold the required opinion.
- *Engineering Construction Pte Ltd v Attorney General & Anor* :
  - Letter stated :
    - *"You have failed to complete the works by 23 December 1991 (the extended date for completion).*

- *In accordance with cl 31 of the conditions of contract, you shall pay the government liquidated and ascertained damages at $3,000 per day for the period during which the said works shall remain or have remained incomplete..."*
- Court :
  - *"...In my judgment the LAD ('liquidated ascertained damages') letter does not satisfy the requirements of the second condition that the director must certify that in his opinion the works ought reasonable to have been completed within the extended time."*
  - Thus what is required in the contract must be clearly and unambiguously specified and not left for inference, matter how obvious the date by which the contractor should have completed his work.

All rights reserved ©

Liquidated Damages and Time of Completion

- When the right to liquidated damages commences
  - When a specified event of default occurs, subject to conditions precedent.
  - In construction contracts – late completion
- Acts of obstruction by the Employer
  - The General Rule - The contractor must complete the work by the contractually stipulated completion date. If he fails to do so, he is liable for liquidated damages to the employer.
  - Exception - The employer is not entitled to liquidated damages if by his acts or omissions he has prevented the main contractor from completing his work by completion date.

- What is an "act of prevention"?
  - Act/omission on the employer is part which delays completion;
  - e.g. Variations, delayed instructions, delayed handover.
- In *Peak Construction (Liverpool) Ltd v McKinney Foundations Ltd :*
  - *"If the failure to complete on time is due to the fault of both the employer and the contractor, in my view, the clause does not bite. I cannot see how, in the ordinary course, the employer can insist on compliance with a condition if it is partly his own fault that it cannot be fulfilled".*
  - *If the employer wishes to recover liquidated damages for the failure by the contractors to complete on time in spite of the fact that some of the delay is due to 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 part of the employer".*

All rights reserved ©

- **Effect of Extension of Time (EOT) Clauses**
  - Assists Employer in Acts of Prevention situation
  - Delaying event stipulated in EOT provision – new completion substituted and no LD arises
  - Delaying event not stipulated – if Act of Prevention, then time for completion at large.
- **Effect of time being at large**
  - Time becomes at large when
    a. employer's default resulted in failure to complete on time
    b. no remedy available from EOT provision.
  - No date from which liquidated damages could run and the right to recover them is gone.
  - Employer's Relief – General Damages, i.e. to recover such damages as he can prove as flowing from the contractor's breach.
  - Contractor's obligation - to complete within a reasonable period.

- **Contractor's right to an extension of time**
  - 3 main purposes in having an EOT clause in the contract :
  - To retain a defined time for completion;
  - To preserve the employer's right to liquidated damages against acts of prevention;
  - To give the contractor relief from his strict duty to complete on time in respect of delays caused by designated neutral events, e.g. inclement weather.
- **Hence, extension of time clauses are not solely for the benefit of the contractor.**

All rights reserved ©

EOT Condition Precedent

- **Clause 23(2) SIA Conditions**
  - *"...It shall be a condition precedent to an extension of time by the Architect under any provision of this Contract (unless the Architect has already informed the Contractor of his willingness to grant an extension of time) that the Contractor shall within 28 days notify the Architect in writing of any event or direction or instruction which he considers entitles him to an extension of time, together with a sufficient explanation of the reasons why delay to completion will result" (emphasis added).*
- ***In the case of Aoki Corp v Lippoland (Singapore) Pte Ltd***
  - *"There is good reason for making the timely notification by the contractor of a delay event a condition precedent to extension of time. This is to enable the employer or the architect to verify the claim for extension and to monitor the event and its impact on the progress of the work".*

Are Losses in Excess of Liquidated Damages Recoverable

- **Case Studies**
  - Liquidated Damages clause serves to limit the quantum of recoverable damages to the stipulated sum (Peak Construction).
  - In *Diestal v Stevenson*, there was a contract for the sale of coal that provided for damages to be paid at a fixed rate per ton. The buyer sued for non-delivery and the seller was held liable for the fixed rate despite the buyer's greater actual loss .
  - In *Talley v Wolsey-Neech*, a contract for sale of land provided for liquidated damages imposed on the buyer's failure to complete, calculated based on the differences on the resale price, it was held that the seller was limited to claiming this amount and could not claim for additional damages by way of interest.

    Hence, the employer cannot increase his damages claim by ignoring the liquidated damages clause in cases where actual damage is greater than the stipulated sum.

All rights reserved ©

- Where a clause is struck down as a penalty, it is an established rule that the innocent party can still sue for damages that have arisen from actual loss and damage, subject to the limit imposed by the "penalty" clause.

- See the recent case of *Jobson v Johnson.*

  - *"Although in practice a penalty clause in a contract as described above is effectively a dead letter, it is important in the present case to note that ... that the strict legal position is not that such a clause is simply struck of the contract, as though with a blue pencil, so that the contract takes effect as if it had never been included therein. Strictly, the legal position is that the clause still remains in the contract and can be sued upon, but it will not be enforced by the courts beyond the sum which represents... the actual loss of the party seeking repayment" (emphasis added)*

  - In other words, the party seeking repayment cannot seek enforcement of the full sum stipulated in the clause, but the penalty clause retains its function as a 'cap' on the maximum quantum of damages recoverable.

3 Possible Situations

1. Where LD Clause is Valid & Properly Invoked
   - General Damages then irrelevant. Acts as cap to actual damages, whether lesser or greater.

2. Where LD Clause is Invalid/Time is at large
   - E.g. where LD clause is a penalty, or where delay from Employer's Act of Prevention not covered by LD clause
   - Employer can claim General Damages
   - Is General Damages capped by LD limit?

   Elsey v J.G. Collins Insurance Agencies

   - *"...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....As exprssed by Lord Ellenborough in Wilbeam v. Ashton (1807), 1 Camp. 78, 170 ER 883: "...beyond the penalty you shall not go; within it, you are to give the party any compensation which he can prove himself entitled to". Of course, if an agreed sum is a valid liquidated damages clause, the plaintiff is entitled at law to recover this sum regardless of the actual loss sustained".*

All rights reserved ©

3. **Where LD Clause is Valid & Time not at large but LD clause NOT Properly Invoked**

- **Possible to argue that Employer is limited to properly invoking LD clause with no right to General Damages.**

McGregor on Damages

- ***"... the plaintiff can neither claim unliquidated damages in addition to the liquidated damages which are designed to deal with the loss that has occurred nor elect to ignore the liquidated damages provision and sue only for unliquidated damages."***

Temloc Ltd v Erril Properties Ltd

- ***"I think it clear, both as a matter of construction and as one of common sense, that if (1) clause 24 is incorporated in the contract and (2) the parties complete the relevant part of the appendix, either by stating a rate at which the sum is to be calculated or, as here, by stating that the sum is to be nil, then that constitutes an exhaustive agreement as to the damages which are or are not to be payable by the contractor in the event of his failure to complete the works on time." (at page 39) (emphasis added).***

CONCLUSION

All rights reserved ©