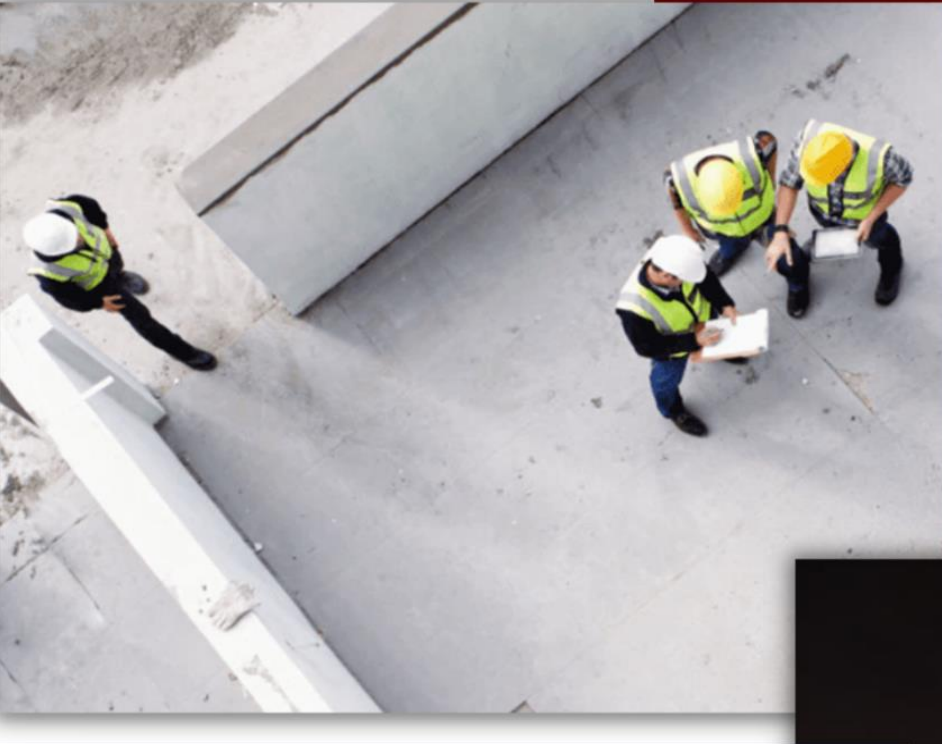


Liquidated Damages



Newsletter

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In this newsletter we will explore the enforceability and application of liquidated damages provisions.

Introduction

Under general legal principles, when a party to a contract claims that another party has breached an agreement the usual remedy sought is damages. This remedy is intended to compensate the non-breaching party for the loss and damage suffered as a result of the breach. As damages are often hard to determine and only calculated after a breach has occurred, it is commonplace in commercial agreements to include a liquidated damages ('LD') clause. An LD clause is a "stipulation in a commercial contract which provides for the payment by the breaching party of a specific or ascertainable sum of money on failure by that party to perform or comply with a contractual provision".¹

LD clauses are utilised in most standard form building and construction contracts. In the construction sector, payment of LD is most often available "for the financial consequences of delayed completion of the relevant project by the contractor at a stipulated monetary rate per day or week or month".²

LD's can be incredibly beneficial for contracting parties for various reasons. Aside from providing certainty as to potential losses, as the LD sum is calculated prior to the execution of the contract, contracting parties are afforded the opportunity to decide if it would be more profitable to sell its performance elsewhere, rather than enter the contract.

Newsletter

In this newsletter, although longer than our usual, we provide a summary of how liquidated damages sums may be calculated and how such a clause is enforceable. At Crisp Law we are increasingly seeing Principal's attempting to co-op Contractor's to accept multiple

¹ Richard Manly, 'The Benefits of Clauses that Liquidate, Stipulate, Pre-Estimate or Agree Damages' (2012) 28(4) *Building and Construction Law Journal* 246.

² Ibid.

liquidated damages entitlements. By way of an example, Crisp Law reviewed an amended AS 4902-2000 contract which provided for 'Liquidated Damages', 'Delay Damages' and 'Milestone Damages'. Similarly, in another form of "D&C" contract there are 'Milestone Liquidated Damages', 'Liquidated Damages' and 'Additional Liquidated Damages'.

Legal Background

The legal test to determine if a stipulation in a contract is a valid LD provision was established by Lord Dunedin in the House of Lords decision of *Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd*.³ In the aforementioned case Lord Dunedin identified that "the essence of liquidated damages is a genuine pre-estimate of damage that a party will suffer due to a breach".⁴ The determination of whether an LD sum is a 'genuine pre-estimate' is "a question of construction to be decided upon the terms" of the contract judged at the time the contract was formed not "at the time of breach".⁵

Though this test was established in the United Kingdom, these principles have been endorsed and approved by the Australian High Court.⁶

In a 2016 decision, the High Court clarified that Lord Dunedin's propositions in *Dunlop* are not "rules of law" but rather "distillations of principle".⁷

Enforceability

Penalty

If an LD sum is found not to be a 'genuine pre-estimate of damage' it may be deemed a penalty and will consequently be unenforceable.

³ [1915] AC 79.

⁴ The Laws of Australia, 'Unfair Dealings' (1 June 2017) 35.10.160.

⁵ [1915] AC 79, 86-87.

⁶ *Ringrow Pty Ltd v BP Australia Pty Ltd* (2005) 224 CLR 656; *Australia & New Zealand Banking Group Ltd* (2012) 86 ALJR 1002.

⁷ *Paciocco v Australia and New Zealand Banking Group Ltd* (2016) 258 CLR 525.

In the High Court decision of *Paciocco* the majority identified that:⁸

*“One way of testing whether the impugned stipulation is penal is to inquire whether the sum that it stipulates to be payable on breach is to ask whether the stipulated sum is **extravagant or out of all proportion to, or unconscionable in comparison with, the maximum amount of damage that might be anticipated to follow from the breach**”.*

Growthbuilt Pty Ltd v Modern Touch Marble & Granite Pty Ltd

In the recent decision of *Growthbuilt* the New South Wales Supreme Court were tasked with identifying whether a subcontract that provided an LD sum at the rate of \$3,500 per date was unenforceable as a penalty.⁹

In presiding over the case Henry J held that the “key question to be determined [was] whether Modern had adduced sufficient evidence of ‘proved circumstances’ to satisfy, on the balance of probabilities, that the sum stipulated by [the liquidated damages clause] should be characterised as ‘extravagant, out of all proportion or unconscionable’ and operated as a penalty”.¹⁰ After considering the evidence Henry J held that while:¹¹

“it might be inferred from that evidence that a liquidated damages rate of \$3,500 per calendar day is on the ‘high side’ given the... residential building project involved a subcontract price for one trade at a cost of \$60,500. That said, the test of whether a particular provision is punitive or penal is not whether the sum stipulated would be considered to be merely disproportionate compared to the likely damage, but whether it has been demonstrated to be extravagant or unconscionably disproportionate. While finely balanced, I have concluded that it is not open to infer from the direct evidence as a whole that \$3,500 per calendar day is out of all proportion, extravagant or unconscionably

⁸ Ibid.

⁹ *Growthbuilt Pty Ltd v Modern Touch Marble & Granite Pty Ltd* [2021] NSWSC 290.

¹⁰ Ibid [97].

¹¹ Ibid [104].

disproportionate to the greatest loss that Growthbuilt could conceivably have suffered in the event of delay or that it was purely punitive in character, noting that loss to Growthbuilt includes all varieties of commercial interests”.

Interestingly, the assessment of damages may also extend to damage or losses caused by the impairment of other legitimate commercial interests that were intended to be protected by the stipulation, such as reputational damage.¹²

Government Entitlement to Claim Liquidated Damages

State of Tasmania v Leighton Contractors Pty Ltd [2005] TASSC 133

This case concerned a contract entered into by the State and Leighton for the “design, construction and maintenance” of a highway. Dispute arose between the parties over delays and costs resulting in complex proceedings. One of the proceedings “concerned the status of the Deed, cl 11, which provide for the payment of \$8,000 per day in the event of non-completion of the construction by an identified date”.¹³ As the State relied on this Deed in withholding funds from the defendant, the defendant claimed that clause 11 was unenforceable as a penalty. At trial the primary judge found that the \$1,832 Million the State deduced as liquidated damages was a penalty.

The State then appealed. One of the grounds advanced by the State was that the trial judge “erred in fact and/or in law in holding or finding that the rate agreed upon between the Appellant and the Respondent for liquidated damages” under the Deed “constituted a penalty”.¹⁴ In overturning the first instance decision, the Court of Appeal found that the initial courts “application of principle was not consistent with the evidence”.¹⁵ Aside from the Court of Appeal finding that the “figure of \$8,00 was not arbitrarily chosen”, the Court of Appeal also found that the trial court was “engaged in an assessment of past loss or an award of damages after the event” when the “test was objective as of the date of the Agreement”.¹⁶ Cumulatively, these factors led the Court of Appeal to conclude that the clause was not a penalty.

¹² *Paciocco v Australia and New Zealand Banking Group Ltd* (2016) 258 CLR 525; *Grocon Constructions (Qld) Pty Ltd v Juniper Developer No.2 Pty Ltd v Anor* [2015] QSC 102.

¹³ [2005] TASSC 133, [2].

¹⁴ *Ibid* [21].

¹⁵ *Ibid* [32].

¹⁶ *Ibid* [31].

Interestingly, in their discussion the Court also considered the ‘public utility’ nature of the work as well as the potential influence of Commonwealth funding. On the note of the projects ‘public utility’, the Court stated that this “does not of itself disentitle the State or public authority from seeking, by way of damages, compensation for loss, the components of which are incalculable”.¹⁷ Moreover, the “test of disproportionality applies equally to public and private institutions in consideration of whether a “breach” clause ought to be regarded as a penalty”.¹⁸ Though the “funding arrangement” between the State and the Commonwealth was “unclear” at the time, the Court explained that “the provision of public money does not change the character of a compensatory provision into one of penalty simply because the expenditure is to be paid by another public authority”.¹⁹ As the grounds were sustained, the appeal was upheld.

Application

Interaction with General Damages

As noted in the introduction, the usual remedy sought for breach of contract is general damages. Accordingly, where parties are governed by an agreement which contains an LD provision it will be a matter of construction as to whether such a clause extinguishes the right to obtain general damages.

The recent Victorian Supreme Court decision of *Hacer Group Pty Ltd v Euro Façade Tech Export Sdn Bhd* has found that there are “two factors” which “in combination weigh heavily in favour of finding that a liquidated damages clause provides an exhaustive remedy for delay”.²⁰ These two factors are:

- (a) if a positive sum of liquidated damages has been stipulated under the contract; and²¹
- (b) if the liquidated damages clause is mandatory.²²

¹⁷ *Ibid* [38].

¹⁸ *Ibid*.

¹⁹ *Ibid*.

²⁰ [2022] VSC 373, [180].

²¹ E.g. *IPN Medical Centres Pty Ltd v Van Houten* [2015] WSC 204.

²² E.g. *Adapt Constructions Pty Ltd v Whittaker* [2015] ATSC 188; *Capello v Hammond & Simmonds NSW Pty Ltd* [2020] NSWSC 1021.

(a) [IPN Medical Centres Pty Ltd v Van Houten \[2015\] QSC 204](#)

In this case the plaintiff entered into a contract with the defendants to buy his medical practice business. In accordance with the provisions under the Sales Contract, the defendant also entered into a ‘Doctors Service Agreement’ to “facilitate general practitioners providing medical services to their patients”.²³ After ceasing practice from the plaintiff’s medical centre, without notice, the defendant purported to terminate the ‘Doctors Services Agreement’. In response, the “plaintiff alleged breaches of” the agreement and “demanded repayment” in accordance with the terms under the Sales Contract.

As an alternative to the claim for damages pursuant to the Sales Contract, the plaintiff also claimed general damages. In challenging the plaintiff’s claim, the defendants alleged that the relevant clause was unenforceable as a penalty as it required the defendants to repay to the plaintiff part of the purchase price for the medical practice. The Court found that the clause was not a penalty which rendered it “unnecessary to consider the plaintiffs alternative claim for [general] damages”.²⁴ The Court further explained that “[i]n any event, the plaintiff would not be entitled to ignore the agreement amount of damages for termination of the doctors services agreement for breach by the first defendant and elect to claim a larger amount as damages for breach of contract at common law”.²⁵

(b) [Capello v Hammond & Simonds \[2020\] NSWSC 1021](#)

The New South Wales Supreme Court in *Capello v Hammond & Simonds* considered the application of a mandatory LD clause for a residential building contract.²⁶ Though the defendant commenced work on 4 September 2017 the renovation work was completed approximately seven months late.²⁷ As the defendant made no “extension of time” applications, the plaintiffs claimed for delay.²⁸ Aside from claiming the “sum of \$370,000” due to the alleged “diminution in the value of the property between the time it ought to have been completed and the time it was in fact completed”, the plaintiffs also claimed

²³ [2015] QSC 204, [15].

²⁴ Ibid [204].

²⁵ Ibid.

²⁶ *Capello v Hammond & Simonds NSW Pty Ltd* [2020] NSWSC 1021.

²⁷ Ibid [24].

²⁸ Ibid.

general damages.²⁹ In response the Builder contended that the plaintiffs were “only entitled to recover \$1 per day, in accordance with the contractual provisions relating to liquidated damages”.³⁰

After considering the nominal fee and the standard form contract, the primary judge held that:

*“the liquidated damages clause in this case should not be interpreted as providing an exclusive remedy for delay. Rather, by specifying the amount of liquidated damages at \$1 per working day, the parties intended not to provide for a substantive right to claim liquidated damages and intended instead to leave the plaintiffs a right to claim damages they could prove they had actually suffered”.*³¹

Interestingly the primary judge stated that “the position, of course, may well be different if the clause had provided for the payment of a substantial amount by way of liquidated damages”³². Nevertheless, the primary judge found that the plaintiff was only entitled to nominal damages as the majority of the delays were due to their requested variations to the works and on the evidence the claim for the diminution in the value of the property had not been made out. Though the plaintiff appealed the primary judge’s decision, “there was no challenge to any part” on the issue of the construction of the LD clause.³³

Conclusion

We started this newsletter by discussing the trend of multiple categories of liquidated damages, in light of the above discussion it is arguable that depending on the drafting of these categories, and the sums awarded, that these multiple clauses may be rendered unenforceable by way of their penal consequences.

For sample LD clauses please refer to the Schedule.

²⁹ Ibid [25].

³⁰ Ibid [26].

³¹ Ibid [32].

³² Ibid.

³³ *Capello v Hammond & Simonds NSW Pty Ltd* [2021] NSWCA 57. [69].

Schedule

Damages for late completion

- a. *If the Sub-Contractor fails to achieve Completion by the Date for Completion, the Sub-Contractor must pay to the Principal:*
 - i. *the liquidated damages stated at item 9 of the Subcontract Particulars for every day after the Date for Completion until the Date of Completion or termination (whichever occurs first); or*
 - ii. *the costs of the Principal's on and off site overheads and any other loss or expense suffered by the Principal as a result of the Sub-Contractor's failure to achieve Completion by the Date for Completion*
- b. *The parties agree the amount for liquidated damages stated in the Sub-Contract Particulars is an agreed genuine pre-estimate of the Principal's loss and damages in the event Completion occurs after the Date for Completion.*
- c. *If the Head Contract Works do not reach Practical Completion by the date for Practical Completion under the Head Contract due to:*
 - i. *a failure of the Sub-Contractor to reach Completion by the Date for Completion under the Sub-Contract, or*
 - ii. *due to a breach of any other obligation under the Sub-Contract by the Sub-Contractor,*
the Sub-Contractor shall indemnify the Principal against any liquidated damages under the Head Contract or any other damages that the Principal becomes liable to pay under the Head Contract.
- d. *If it is determined that the Sub-Contractor's liability to pay the liquidated damages is deemed to be, or becomes, void, invalid or unenforceable for any reason (including because such liquidated damages are a penalty), the Principal may claim general damages for the Sub-Contractor's failure to achieve Practical Completion by the Date for Practical Completion.*

Completion

- (a) *If the Subcontractor fails to achieve Completion by the Date for Completion, the Subcontractor must pay to the Contractor the liquidated damages stated in the Subcontract Particulars for every day after the Date for Completion until the Date of Completion or termination (whichever occurs first). The parties agree the amount for liquidated damages stated in the Subcontract Particulars is an agreed genuine pre-estimate of the Contractor's loss and damages in the event Completion occurs after the Date for Completion, as listed in item 18 of the Subcontract Particulars.*