

Basic Principles of Liquidated Damages

In this newsletter we explore some of the important principles behind liquidated damages under English law. While we refer throughout this newsletter to liquidated damages for a failure to complete the works by the agreed time for completion, the principles apply equally to liquidated damages for failing to meet performance guarantees.

Liquidated and unliquidated damages

Most standard forms of construction contracts provide that the contractor has a duty to complete the works by a specified time, whether by a particular date or within a set number of weeks or months. If there is no specified time for completion, then a term will be implied into the contract such that the contractor is obliged to complete the works within a reasonable period of time.

If the contractor fails to complete the works by the specified time, or within a reasonable period of time, it will be in breach of contract and liable to the employer in damages. Parties commonly agree that a liquidated (fixed and agreed) sum will be payable as damages for the failure to complete by the specified time. Liquidated damages are often calculated on a daily or weekly basis, and as a percentage of the contract price, and should be a genuine pre-estimate of the employer's loss arising as a result of the delayed completion.

If the liquidated damages clause for any reason is found not to be enforceable, the contractor will still be liable to the employer for unliquidated, or general, damages. There is one exception to this rule, and that is if the parties have agreed that no damages, whether liquidated or unliquidated, will be payable for late completion of the works.

No liability for damages

In the case of *Temloc v Errill*¹, when the parties completed the appendix to an English standard form of building contract, they had entered "£ nil" against the relevant liquidated damages clause and the period over which payment was to be made (i.e. daily, weekly or otherwise) was left blank. The works were completed some three months late and the employer claimed general damages for the contractor's failure to complete by the date specified in the contract.

The Court of Appeal held that the effect of "£ nil" was not that the liquidated damages clause simply should be disregarded, but that on a proper construction of the contract it had been agreed that there should be no damages at all for delayed completion. The Court of Appeal's reasoning was that, if a mandatory liquidated damages provision is incorporated into the contract and the parties complete the relevant part of the appendix either by stating a rate at which the damages are to be calculated or, as was in that case, by stating that the sum is "nil", then that "*constitutes an exhaustive agreement as to the damages that are or are not to be payable by the contractor in the event of the failure to complete the works on time*".

An exhaustive remedy for delays

The nature and effect of a liquidated damages clause will always depend on its construction. However, applying *Temloc v Errill*, the general position is that a liquidated damages clause will cover all damages for non-completion and will therefore amount to an exhaustive remedy for all losses arising as a result of the delay. The employer will not be able to elect to pursue a claim for general damages in the hope of recovering sums over and above the contractual rate of liquidated damages. Nor will the employer

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Contacts



Peter Godwin

Partner

Registered Foreign Lawyer

Tel: +81 3 5412 5412

E: peter.godwin@herbertsmith.com



Dominic Roughton

Partner

Registered Foreign Lawyer

Tel: +81 3 5412 5412

E: dominic.roughton@herbertsmith.com



David Gilmore

Partner

Registered Foreign Lawyer

Tel: +81 3 5412 5412

E: david.gilmore@herbertsmith.com



Emma Kratochvilova

Senior Solicitor

Tel: +81 3 5412 5412

E: emma.kratochvilova@herbertsmith.com

¹ *Temloc Ltd v Errill Properties Ltd* (1987)

be able to claim general damages in addition to the liquidated damages provided in the contract.

In the recent case of *Biffa*², the contract provided for liquidated damages capped at 7.5% of the contract price. In addition to claiming liquidated damages, the employer also tried to recover unliquidated damages for delays to completion caused by breaches of other contractual obligations. Applying *Temloc v Errill*, the Court rejected the claim, holding that if there is a failure to complete then the liquidated damages will be an exhaustive remedy for the default and, "[i]f there is a breach of another obligation and that breach causes a failure to complete then liquidated damages are still the only monies due for that default, that is a breach of contract causing a failure to complete on time".

Liquidated damages can benefit both parties

The benefits of a liquidated damages provision to the employer are obvious: the employer can be certain to recover a specified sum as soon as the date for completion of the works has been missed without having to prove its actual losses. In most cases the employer will be able to deduct or set-off the liquidated damages against sums owed to the contractor. Importantly, the employer does not have to have suffered actual loss to claim liquidated damages.

However, liquidated damages can also prove to be advantageous to contractors. As liquidated damages will in most cases provide an exhaustive remedy for delays to completion, the contractor will have the benefit of knowing at the outset of the project exactly how much it will have to pay if it is not able to complete the works within the employer's deadline. A contractor will often be in a position to negotiate the rate of liquidated damages, together with a cap on liability, and allow for the risk of late completion in its bid price.

Challenging liquidated damages

Some contractors are quick to challenge the validity of a liquidated damages provision in the hope of avoiding liability to pay damages for late completion. However, as discussed in our August 2009 Newsletter³, the contractor's liability for delay will not be extinguished just because a liquidated damages clause is unenforceable; the contractor will still be liable for general damages. Further, there is no definitive view under English law as to whether general damages will be limited to the level of liquidated damages agreed in the contract.

Nonetheless, in many cases, the employer may find it difficult to prove its losses for the purposes of a claim for general damages, so the contractor could have much to gain by challenging a liquidated damages provision. We will explore the various grounds on which to challenge liquidated damages in the next Construction Disputes Avoidance Newsletter.

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Herbert Smith LLP, 41st Floor, Midtown Tower, 9-7-1 Akasaka, Minato-ku, Tokyo 107-6241.

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² Biffa Waste Ltd v Machinfabrik Ernst Hese GMBH (2008)

³ Construction Disputes Avoidance Newsletter August 2009: The Prevention Principle, Time at Large and Extension of Time Clauses