

LIQUIDATED DAMAGES IN CONSTRUCTION CONTRACTS: IS THERE A SCHISM BETWEEN THE AUSTRALIAN AND ENGLISH COURTS?

Steve Donohoe¹ and Jeremy Coggins²

¹ School of Architecture, Design and Environment, University of Plymouth, UK

² School of Natural and Built Environments, University of South Australia, Adelaide, Australia

It is very common for construction contracts to include a clause which provides for compensation to be paid in the event of a breach. Where a breach of contract involves a delay in finishing a construction project the usual mechanism used for compensation is liquidated damages (LD). Although LD clauses have been used in construction contracts for over 150 years they have often been controversial and formed the basis of some bitterly contested cases in the Commonwealth. One of the most contested issues concerns where an employer wishes to dispense with LD and claim against the contractor for losses actually incurred, ie unliquidated damages (ULD). Following the well known English case of *Temloc v Errill Properties Ltd* (1987), it has been established for a period of nearly a quarter of a century that the insertion of "NIL" against the LD clause excludes the recovery of LD and ULD in these cases. Two recent Australian cases, *Silent Vector t/a Sizer Builders v Squarcini* (2008) and *J-Corp v Mladenis* (2009), have further widened a split in this respect that first occurred in the case of *Baese Pty Ltd v RA Bracken Building Pty Ltd* (1990) between the English approach and the Australian approach. The English approach is exhaustive and promotes inconsistency in contrast to the Australian approach which was found to be practical and pragmatic. Ironically the Australian approach relies in part on an English case of the highest authority.

Keywords: Australia, construction law, England, liquidated damages, unliquidated damages.

INTRODUCTION

It is very common for construction contracts to include a clause which provides for compensation to be paid in the event of a breach of contract. Where a breach of contract results in a delay in finishing the construction works the usual mechanism used for compensation is Liquidated Damages (LD). Adriaanse (2010: 177) observes that the function of LD is:

to act as an inducement to 'due performance of particular contractual obligations, or to regulate beforehand in an agreed and certain manner the rights of the parties'. Failure to do so leaves the parties the less predictable remedies available at common law for breach of contract.

Actual damages sought in common law need to be proved in court and are often termed unliquidated damages (ULD) to distinguish them from LD which are contractually binding pre-estimates of damage. The advantage that LD has over ULD

¹ sdonohoe@plymouth.ac.uk

is that parties know at the beginning of a contract the extent of liability to which they are exposed and therefore avoid expenditure of time and money on formal dispute resolution processes such as litigation or arbitration (Murdoch & Hughes 1999: 327).

As far as the Law of England is concerned the Courts seem to have developed an antipathy to LD and, consequently, interpret LD clauses contained in construction contracts very strictly. No one seems to know the origins or precise date when this policy arose, but it is well established that LD clauses are interpreted *contra preferentem* (against the party seeking to rely on the LD clause). In a construction context, this usually means against the Employer. In other words, it seems to be tolerably clear that in the event of ambiguity the English Courts are likely to rule against the Employer where there is the merest whiff of contention concerning LD clauses.

Support for this argument can be found in *Peak Construction (Liverpool) Ltd v McKinney Foundations Ltd* (1970) 1 BLR 11 where Salmon LJ observed, "If a failure to complete on time is due to the fault of both the employer and the contractor, in my view, the [LD] clause does not bite". This was re-affirmed in *Percy Bilton Ltd. v Greater London Council* (1982) 20 BLR 1 where Lord Fraser stated that a line of cases can be traced back to *Holme v Guppy* (1838) 3 M & W 387 as an established legal precedent.

This has led parties and their advisors in some cases to try to dispense with LD and attempt to sue for ULD instead. Such an approach, if successful, would be particularly advantageous to the Employer where their actual losses flowing from the breach have greatly exceeded the amount agreed in the contract for LD.

In *Surrey Heath B.C. v Lovell Construction Ltd* (1988) 42 BLR 25 (henceforth "Surrey Heath") the Employer attempted to waive their rights to LD and attempted to sue for ULD. HHJ Fox-Andrews QC emphatically rejected this attempt to circumvent the recovery of LD. The logic behind the learned judge's reasoning is that where the parties have agreed in advance that LD will be payable in the event of a delay then it would be unreasonable and unfair if one party might dispense with the agreement to gain a financial advantage. This judgement is supported by earlier case law in *Diestal v Stevenson* [1906] and *Cellulose Acetate Silk Co Ltd v Widnes Foundry* (1925) Ltd [1933] AC 20.

The converse must also be true. Where the actual losses to the Employer are less than the amount of LD, then the Employer may still recover the agreed amount of LD in full. Support for this argument can be found in *BFI Group of Companies v DFB Integration Systems Ltd* (1997) CILL 348 (henceforth "BFI"). This, however, is subject to the requirement for a LD amount to represent a genuine pre-estimate of loss and not amount to a penalty. If a LD amount is found to be a penalty, it will be unenforceable and losses caused by the relevant breach will only be recoverable by way of ULD. Authority for this statement can be found in the English case of *Dunlop Pneumatic Tyre Co v New Garage and Motor Co* [1915] and the Australian case of *Ringrow Pty Ltd v BP Australia Pty* (2005) 224 CLR 656 respectively.

What is not covered by *Surrey Heath* or *BFI* is the situation where an attempt is made to exclude LD in favour of an action for ULD where the stated amount of LD is not a positive amount. The classic and authoritative case in English Law is *Temloc Ltd v Erril Properties* (1987) 39 BLR 30 (henceforth "Temloc"). The Australian Courts, however, have failed to be persuaded by *Temloc*, and there have been three Australian

decisions since 1990 which appear to be diametrically opposed to that of the English position.

THE ENGLISH POSITION: TEMLOC

In Temloc, Temloc entered into a contract with Errill for the construction of a shopping centre in Plympton, near Plymouth in the South West of England for £840,000. The contract completion date stated in the appendix was 28th September 1984 but practical completion was not certified until 20th December 1984. The Architect subsequently reviewed the contractor's claims for extension of time and certified a revised completion date of 14th November 1984.

Clause 24 of the contract contained the LD clause. In the conditions of the contract the relevant entry in the appendix contained an insertion "£NIL".

Powell-Smith and Furmston (1990: 348-349) eloquently identified the issue and two sub-issues to be decided by the Court of Appeal as:

[The issue]

Whether upon a true construction, the Contract made between Temloc and Errill ...entitles Errill to claim any relief as a result of any failure to complete the contract works either by the date specified in the contract or any other later date certified or within a reasonable time and if so precisely what relief and in what circumstances.

[Sub-issue 1]

Does the inclusion of "£NIL" nevertheless permit a claim for (a) damages at large [ULD] or (b) for an indemnity.

[Sub-issue 2]

If the effect of the £NIL entry is to preclude a claim.....can Errill nevertheless have a claim in respect of a failure to complete within a reasonable time?

In respect of the issue, the Court of Appeal decided that the Employer (Errill) was not entitled to any relief because Clause 24 was exhaustive.

In respect of sub-issue 1, the effect of '£NIL' in the appendix was to provide a negative amount for LD. In other words the insertion was valid and provided an agreed remedy between the parties in the event of delay. In other words LD for the six weeks (approximately) delay not covered by an extension of time for the period 14th November to December 20th operated thus: 6 weeks x £NIL = NIL. Therefore, Errill recovered the amount they had agreed to, namely, "NIL".

In respect of sub-issue 2, Errill were not permitted a claim for Temloc's failure to complete within a reasonable time because clause 24 provided an exhaustive remedy, or as Nourse L.J. stated:

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....Their character [i.e. the damages] is not in any way altered according to whether the rate at which they are payable is agreed by the parties in advance, so that they become liquidated, or determined by the court after breach, so that they remain unliquidated until so determined.

His Lordship later considered the effect of Clause 24.1 (which requires a certificate of the architect to be issued) and further added:

Viewing the clause in this way, I find it impossible to attribute to parties who complete the appendix in one way or the other an intention that the employer shall have the option of claiming damages of precisely the same character but in an unliquidated amount.

In other words, accepting his Lordship's view that LD and ULD are merely different manifestations of the same damages, if an enforceable pre-agreed amount for LD exists, it must be applied and prevail over ULD when assessing the damages for late completion (Thomas 2008: 87).

In *Chattan Developments Ltd. v Reigill Civil Engineering Contractors Ltd* [2007] EWHC 305 (TCC) (henceforth "Chattan"), The Hon. Justice Ramsey confirmed the decision in *Temloc* and noted:

when there is a valid and enforceable liquidated and ascertained damages clause within an agreement, those damages are the sole remedy for the particular breach to which they relate, commonly delay in completion. Unliquidated damages are not recoverable because the parties' agreement of liquidated damages replaces the remedy which would otherwise be available for breach. (para 31)

The decision in *Chattan* cemented the position in English Law that the inclusion of a LD clause excludes the right to recover ULD. It was also decided in *Chattan* that where the LD clause was deleted from the contract then this was clear that the parties intended that no damages at all could be recovered for delay. In other words both LD and ULD are excluded by the deletion.

THE AUSTRALIAN POSITION: THE BAESE, SQUARCINI AND J-CORP CASES

In *Baese Pty Ltd v RA Bracken Building Pty Ltd* (1990) 6 BCL 137 (henceforth "Baese"), the parties inserted "\$nil" at the appropriate item in the Appendix in the standard JCC-B 1985 form of contract. When the builder failed to bring the works to practical completion by the date for practical completion, the principal brought a claim for ULD. Clause 10.14 of the contract provided that:

- the Architect may give a written notice to the Builder and to the Proprietor that in his opinion the Works ought reasonably to have been brought to Practical Completion at some earlier date to be stated in that notice; and,
- If such a notice is given then the Builder shall pay or allow to the Proprietor LDs at the rate stated in the relevant item of the Appendix.

The approach adopted by Giles J in interpreting the LD clause was, as noted by Thomas (2008: 86), that each case needs to be considered in light of the particular terms in the applicable contract. As *Dorter & Sharkey* (2007: 4749) have subsequently put it, "The quintessence of the issue here is that the cardinal rule of interpretation and construction of contracts, viz the intention of the parties, ascertained objectively from the words evidencing their meaning".

Giles J found that the function of cl 10.14 was to allow the proprietor the discretion, via either causing or not causing the architect as his agent to invoke the relevant contractual machinery, to claim LD (ie, a non-mandatory LD clause). His Honour held that if the proprietor did not exercise their option to claim LD, then the proprietor was entitled to rely upon his common law right to damages for breach of the contract.

Further, his Honour held that in order for such a clause to constitute an exhaustive remedy for damages due to late completion, it would require clear words that the liquidated damages clause was the entirety of the proprietor's rights because, otherwise, the proprietor would be exposed to being left with no entitlement at all to damages for delay. Thomas (2008: 88) cites this consideration of the Court as an example of the Court taking into account commercial circumstance in the interpretation of contractual wording.

His Honour, therefore, held that clause 10.14 was not an exhaustive agreement as to the damages for delay thereby distinguishing Baese from Temloc.

In *Silent Vector Pty Ltd t/a Sizer Builders v Squarcini* [2008] WASC 246 (henceforth "Squarcini") the Supreme Court of Western Australia upheld an arbitrator's decision that the insertion "N/A" (presumably an abbreviation of "Not Applicable") in the LD clause, although clearly excluding a right to recover LD, did nothing to exclude the recovery of ULD for losses incurred by the employer. The Court held that it was not convinced that this insertion meant that the parties intended that no damages at all were to be recoverable for delay.

In *Squarcini*, the parties used the Australian Standard General Conditions of Contract AS2124-1992, cl 35.6 of which states:

If the Contractor fails to reach Practical Completion by the Date for Practical Completion, the Contractor shall be indebted to the Principal for liquidated damages at the rate stated in the Annexure for every day after the Date for Practical Completion to and including the Date of Practical Completion or the date that the Contract is terminated under Clause 44, whichever first occurs.

The question as to whether this clause represented a mandatory LD provision or not, and thereby constituted an exhaustive remedy for damages due to late completion, was not considered by the arbitrator. The Court, however, did not deem this to be sufficient to disturb the arbitrator's original decision on the basis of an error of law, considering it sufficient that "the learned arbitrator's reasoning was based on the facts, particularly the express terms of the Contract and the surrounding facts, such as they were known to the learned arbitrator" (para 83).

The Court's endorsement of the basis for the arbitrator's reasoning in *Squarcini* indicates a move towards a contextual approach to interpreting LD clauses in Australia, which has been subsequently further developed in *J-Corp Pty Ltd. v Mladenis* [2009] WASCA 157 (henceforth "J-Corp").

In *J-Corp*, a builder (J-Corp) entered into a building contract with an employer (Mladenis) to construct a three storey house for the sum of A\$311,484.12. The Contract was a standard form used by J-Corp. Clause 11.9 of the Contract provided that if the Builder failed to reach practical completion by the due date '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'.

J-Corp did not reach practical completion within the specified period and the employer sought to recover ULD as a result of the delay. J-Corp (citing the English case of *Temloc* as authority) argued that the insertion of \$NIL DOLLARS in the LD clause excluded both LD and ULD. The Court of first instance rejected J-Corp's argument. J-Corp appealed.

The critical issue in the appeal was whether the judge of first instance (Schoombie DCJ) had applied the law incorrectly in making her decision that the Contract did not exclude any entitlement of the employer to claim ULD.

Newnes JA gave the leading judgement in the appeal. Newnes JA considered various English and Australian cases including Temloc. He stated that it:

is trite law that great caution must be exercised in seeking to apply the meaning given to a word or words in one contract to the same word or words in a different contract. That is obviously because commonly the meaning of words is affected by the particular context in which they are used. (para 39)

Whilst Newnes JA agreed with Nourse LJ's view in Temloc that it is the case that LD and ULD for delay are simply different forms of the same head of damage, he contended there is an important and clear distinction between the two forms in which the damages may be recovered as follows:

A liquidated damages provision in a contract relieves the owner of the obligation of proving actual damage caused by the delay and permits a relatively simple claim for the agreed amount. In the absence of such a provision, in the event of delay the owner will be left with a potentially costly and time-consuming remedy in unliquidated damages, a remedy that in many circumstances, particularly in respect of a contract for the construction of a house, it may not be practical or worthwhile to pursue. (para 49)

As such, his Honour viewed, in contrast to Temloc, that the insertion of 'NIL DOLLARS (\$00.00)' in the LD provision:

did not 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. (para. 50)

Newnes JA's did not attribute 'any significant weight' (para 52) to the mandatory nature of the wording in the relevant LD provision that the Builder shall be liable to pay the Proprietor liquidated damages. Indeed, his Honour stated:

In the present case, to say that the appellant 'shall be liable to pay ... liquidated damages at the rate of NIL DOLLARS (\$00.00)' is to say no more than that the appellant shall not be liable to pay any amount by way of liquidated damages, albeit to say it in a somewhat clumsy fashion. Indeed, there is, with respect, an artificiality about talking of a mandatory liability to pay nothing. (para 52)

Additionally, in forming his decision, Newnes JA took into account the following contextual factors:

- The parties did not communicate with each other with regard to the LD provision or the inclusion in it of the words and symbol 'NIL DOLLARS (\$00.00)'. (para 43)
- Under contract, the appellant (Builder) was entitled to recover any extra costs it incurred by reason of the respondent's (Proprietor's) delay. As such, if the LD clause was interpreted to preclude the respondent from claiming any loss they incur by reason of the appellant's delay, an unequal arrangement would result and it was not evident why the respondents should be taken to have agreed to such an unequal arrangement. (paras 53 & 54)
- There was a clause in the contract excluding the appellant from any responsibility for delays outside its control. Such a clause, read in its context,

is more consistent with a recognition of the existence of a right in the respondents to claim unliquidated damages for delay. (paras 55 & 56)

- There was a clause in the contract which expressly released the appellant from any liability for loss or damage suffered by the respondents in respect of the imposition of tax as a result of delay in the performance of the work. This clause also appeared to be consistent with the existence of a right in the respondents to claim damages for delay. (para 57)

Having adopted such a contextual approach and interpreting the LD clause so as not to exclude the Proprietor's right to claim ULD, Newnes JA considered that clear words would be needed "to rebut the presumption that a contracting party does not intend to abandon any remedies for breach of contract arising by operation of law" (para 44). As authority for this, Newnes JA cited the judgment of Lord Diplock in the English case of *Gilbert-Ash (Northern) Ltd v Modern Engineering (Bristol) Ltd* [1974] AC 689 (henceforth "Gilbert-Ash"). Newnes JA found that, "In the present case, I am unable to find in the Contract any clear words expressing an intention that the respondents are not to be entitled to claim unliquidated damages for delay" (para 47).

Newnes JA, therefore, concluded that the first instance judge had applied the law correctly. The two other judges hearing the appeal concurred with Newnes JA.

DISCUSSION

The question to be asked is whether Temloc (English position) and J-Corp (Australian position) can be reconciled? Whilst it could be argued that Temloc used an amended JCT standard form whereas the J-Corp was the builder's own form, the similarities are striking in that both Temloc and J-Corp contained a monetary amount of Nil in their LD provisions, and the relevant LD provisions in both cases appeared to be mandatory in nature. However, the verdicts of the respective Courts are polar opposites.

The approach of the English Courts, characterised by the decisions in *Temloc* and *Chattan*, is that any insertions in the LD clause represent an exhaustive remedy negating the recovery of LD as well as ULD. This has come as a surprise, to say the least, to employers who have spent a great deal of time and money trying to recover losses caused through their contractor's delay on their projects.

The Australian Courts' approach, highlighted by the decisions in *Baese*, *Squarcini* and *J-Corp* appears to be diametrically opposed to that of English Law. Initially, the Court in *Baese* distinguished the English position on the basis of the mandatory nature of the wording of the LD clause in *Temloc*. It appears, however, that following *Squarcini* and *J-Corp* this basis of distinction is no longer the sole critical factor to the right of a principal to claim ULD where \$NIL or N/A is inserted in the LD clause. The Australian courts are now prepared to uphold such a right to ULD where the particular context in a case justifies such interpretation and there are no clear words expressing an intention to the contrary. The Australian approach accords with the shift in contractual interpretation seen in contemporary Australian jurisprudence, as discussed by Thomas (2008: 87-88), from a literal standpoint to one based more on context. To support this argument Thomas (*ibid.*) cites Spigelman (2001: 322); *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337 per Mason J at 348; *K & S Lake City Freighters Pty Ltd v Gordon & Gotch Ltd* (1985) 157 CLR 309 per Mason J at 315; *McCann v Switzerland Insurance Ltd* (2000) 203 CLR 579 per Gleeson CJ at 589.

It may perhaps be seen as somewhat ironic that the Australian approach partly relies on an English case (Gilbert-Ash), which has only a tenuous link as the case concerns rights of set-off rather than the recovery of damages for delay. Nevertheless Gilbert-Ash is critical to the Australian approach.

CONCLUSION

The English approach is fraught with difficulty in that it tries to second guess the intention of the parties. The historical antipathy of the (English) Courts towards LD has the potential to lead to inconsistency and injustice, at least from the employer's perspective.

In interpreting LD clauses, the contemporary Australian approach considers the express terms of the contract, surrounding facts and commercial considerations relating to each individual case. It is contended that this case-by-case contextual approach represents a far more practical, pragmatic and fair method by which to ascertain the true intent of the contracting parties. It is more suited to the needs of modern commerce rather than ancient doctrines of dubious jurisprudence.

Perhaps the time has come where the English Courts ought to recognise the commercial reality of modern construction contracts, abandon their traditional antipathy towards LD clauses and rectify the schism between English and Australian law.

REFERENCES

- Adriaanse, J. (2010), *Construction Contract Law*, 3rd Edition Basingstoke, Palgrave MacMillan, Hants, UK.
- Dorter, J. B. and Sharkey, J. J. A. (2007), *Building and Construction Contracts in Australia*, 2nd Edition, Thomson Lawbook Co., Sydney, Australia.
- Murdoch, J. and Hughes, W. (1999), *Construction Contracts: Law and Management*, 3rd Edition, E & F H Spon, London, UK.
- Powell-Smith, V. and Furmston, M. P. (1990), *A Building Contract Casebook*, 2nd Edition, BSP Professional Books, Oxon, UK.
- Thomas, T. (2008), "Nil liquidated damages: An exhaustive remedy for delay under a construction contract?", *Building & Construction Law*, **24**, 82.