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CHALLENGES TO LIQUIDATED DAMAGES FOR DELAY

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1.0 Liquidated Damages for Delay

Most construction contracts contain elaborate machinery which fixes an initial date for completion of the works, and for extensions of time to the original date for completion for specific delay events. Rather than general damages for delay, most construction contracts also provide for payment by the contractor of specified amounts for each period of delay, referred to as liquidated damages.

The advantage of stipulated liquidated damages is that proof of loss for delay in construction contracts can be difficult and time consuming, and where liquidated damages are stipulated, an owner is not required to prove his loss:¹

"The very reason why the parties do in fact agree to such a stipulation is that sometimes, although undoubtedly there is damage and undoubtedly damages ought to be recovered, the nature of the damage is such that proof of it is extremely complex, difficult and expensive."

Where a contractor has failed to complete on time, he is *prima facie* liable to a claim for liquidated damages, and the contract often gives the owner the right to deduct these amounts. Whilst there is no inquiry into the actual loss suffered, contractors faced with deduction of liquidated damages or actions to recover such sums, will often resist payment by raising various defences. Common defences raised by contractors include (1) that the sum is a penalty, (2) that he is no longer obliged to complete the works by the specified date, that is, time is "*at large*", or (3) that the owner has taken over the works.

If the contractor establishes a defence against liquidated damages for delay, it may still leave the owner the right to claim general damages for delay in the normal manner.

This article discusses some of the common defences to liquidated damages for delay raised by contractors, and examines current case law developments.

¹ *Clydebank Engineering Co v Don Jose Yzquierdo y Castandeda* [1905] AC 6 at 11, HL.

2.0 The Agreed Sum is an Unenforceable Penalty

2.1 General Principles

If an agreed sum is a penalty it will not be enforced by a court or tribunal. This is an exception to the general common law principle that a contract should be enforced in accordance with its terms. The prohibition on penalties is also consistent with the common law principle that damages are compensatory, and therefore, a plaintiff cannot recover an amount which bears little or no relationship to the actual loss suffered by a plaintiff.²

The principles of whether a stipulated sum is a penalty or liquidated damages are well established, and were summarised by Lord Dunedin in his classic statement in the House of Lords in *Dunlop Ltd v New Garage Co Ltd*:³

“1. 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 is not conclusive. The court must find out whether the payment is in truth a penalty or liquidated damages...”

The decision in *Clydebank Engineering Co v Don Jose Yzquierdo y Castaneda*,⁴ is an example where the relevant provision referred to the “*penalty for later delivery shall be at the rate of 500l per week for each vessel*”, but regardless of use of the term “*penalty*”, the House of Lords held the sum to be a genuine pre-estimate of loss and therefore recoverable.

“2. The essence of a penalty is payment of money stipulated as in terrorem of the offending party; the essence of liquidated damages is a genuine covenanted pre-estimate of damage.”

The distinction between the two is that in the case of a penalty, its function is to deter a party from breaching the contract, rather than to compensate the innocent party for the breach. In the case on a monetary penalty, this is usually assessed by comparing the amount payable upon breach with the loss that might be suffered had the breach occurred. In *Lordsvale Finance Plc v Bank of Zambia*, Coleman J stated:⁵

“That the contractual function is deterrent rather than compensatory can be deduced by comparing the amount that would be payable on breach with the loss that might be sustained if breach occurred.”

However, an agreed sum may not be a genuine pre-estimate of loss, yet still not be a penalty. This occurs often in construction contracts where the parties agree for a contractor not to be liable for payment of the full amount of compensatory damages for delay, and intentionally limit his liability to a lesser sum. Indeed, this is often the primary purpose of parties agreeing a stipulated sum as an exclusive remedy for delay.

² Refer to *Export Credits Guarantee Department v Universal Oil Products* [1983] 2 Lloyd’s Rep 152, at p155, per Lord Roskill.

³ [1915] AC 79 at p86, HL.

⁴ [1905] AC 6 HL.

⁵ [1996] QB 752, at p762.

“3. The question whether a sum stipulated is 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 the making of the contract, not as at the time of the breach.”

It is not sufficient to establish that a provision is penal by identifying situations where the provision may result in a larger sum being recovered by the injured party than the actual loss, since the assessment is judged as at the time of making the contract.⁶

Lord Dunedin in *Dunlop Ltd v New Garage Co Ltd* went on to formulate four tests to assist parties in assessing whether a stipulated sum is a penalty or not, as follows:

“4. To assist this task of construction various tests have been suggested, which if applicable to the case under consideration may prove helpful, or even conclusive. Such as:

- (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 that could conceivably be proved to have followed from the breach.
- (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. This though one of the most ancient instances is truly a corollary to the last test....”
- (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 damage.’
- (d) It is no obstacle to the sum stipulated being a genuine pre-estimate of damage, that the consequence 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.”

An example of the test referred to in paragraph (d) above, is the decision in *Phillips Hong Kong v Attorney-General of Hong Kong*,⁷ where the Hong Kong government assessed the liquidated damages amount by reference to the loss of return on the total value of capital involved. The Privy Council considered this to be a sensible approach in a situation “*where it would be obvious that substantial loss would be suffered in the event of delay but what that loss would be would be virtually impossible to calculate precisely in advance.*”

2.2 Modern Approach

Whilst courts consistently apply the above well-established principles, the courts’ modern approach in Commonwealth jurisdictions demonstrate a marked reluctance to strike down a liquidated damages provision as a penalty for a contract freely entered into by the parties. Rather, the courts’ general trend is to emphasise the parties’ freedom of contract, to preserve the commercial certainty provided by liquidated damages provisions, and not to examine with arithmetical precision the difference between the stipulated sum and the quantum of damages that would have been recoverable.

⁶ *Phillips Hong Kong v Attorney-General of Hong Kong* (1993) 61 BLR 41, at p58

⁷ (1993) 61 BLR 41, at p60.

For example, the Supreme Court of Canada emphasised the principle of freedom of contract in *Elsely v J G Collins Insurance Agencies*,⁸ as follows:⁹

“The power to strike down a penalty clause is a blatant interference with freedom of contract and is designed for the sole purpose of providing relief against oppression for the party having to pay the stipulated sum. It has no place where there is no oppression.”

The court’s reference in *Elsely* to the principle of freedom of contract in agreeing a stipulated sum was referred to with approval by the Privy Council in *Phillips Hong Kong Ltd v Attorney General of Hong Kong*, and by the Australian High Court in *Esanda Finance Corporation Ltd v Plessnig*.¹⁰

In a construction context, Coulson J in *Liberty Mercian Ltd v Dean & Dyball Construction Ltd*, recently also stressed the principle of freedom of contract:¹¹

“The courts have always been wary of allowing one party to a contract to avoid the consequences of a liquidated damages provision freely entered into.”

Mason and Wilson JJ, in the Australian High Court in *Amev-Udc Finance Ltd v Austin*,¹² emphasised the benefit of commercial certainty of contractual provisions for agreed compensation (emphasis added):¹³

“Instead of pursuing a policy of restricting parties to the amount of damages which would be awarded under the general law or developing new law of compensation for plaintiffs who seek to enforce a penalty clause, the courts should give the parties greater latitude to determine the terms of their contract. In the case of provisions for agreed compensation and, perhaps, provisions limiting liability, that latitude is mutually beneficial to the parties. It makes for greater certainty by allowing the parties to determine more precisely their rights and liabilities consequent upon breach or termination, and thus enables them to provide for compensation in situations where loss may be more difficult or impossible to quantify or, if quantifiable, may not be recoverable at common law. And they may do so in a way that avoids costly and time-consuming litigation.”

The court went on to comment that courts should not examine too readily the degree of disproportion between the stipulated amount and the quantum of damages that would have been recoverable, as follows:¹⁴

“The courts should not, however, be too ready to find the requisite degree of disproportion lest they impinge on the parties’ freedom to settle for themselves the rights and liabilities following a breach of contract.”

In summary, the courts’ modern approach is not to readily interfere with the freedom of parties to contract. Even where some “*oppression*” exists, courts impose a high threshold, and will not assess the amount of liquidated damages with arithmetical precision.

⁸ (1978) 83 DLR (3rd) 1.

⁹ (1978) 83 DLR (3rd) 1 (SCC), at p15.

¹⁰ (1989) 166 CLR 131, at para 9

¹¹ [2009] BLR 29, at para 13.

¹² [1986] 162 CLR 170, per Mason and Wilson JJ, at para 41.

¹³ *Ibid*, at para 41.

¹⁴ *Ibid*, at para 41.

2.3 Sectional Completion

Problems can arise where a single sum is stipulated for liquidated damages but where parts of the works are completed at different times or where the employer takes possession of a part of the works prior to completion of the entire works.

For example, in *Braes of Doune Wind Farm (Scotland) Ltd v Alfred McAlpine Business Services Ltd*,¹⁵ Akenhead J considered an application for leave to appeal an arbitrator's award, in which the arbitrator had decided that the liquidated damages provision was an unenforceable penalty. Akenhead J admitted that his initial impression was to uphold the liquidated damages provision, but after analysing the relevant provisions, concluded that the arbitrator was "*ultimately right*".

The parties entered into an engineering, construction and procurement ("EPC") contract, which was modeled upon the FIDIC "*Silver Book*", for Alfred McAlpine to construct the foundations and all related civil and electrical works for a wind power farm to be constructed in Scotland. Braes of Doune, the developer, also engaged a separate contractor (the "Wind Turbine Contractor"), to design, construct and install the 36 wind turbines.

The contract contained a liquidated damages provision which specified delay damages at various rates per day, depending upon the time of year, for each MW of the total capacity of the plant unavailable at the contract completion date. There was no provision in the contract for sectional completion, and therefore until all 36 wind turbines were complete and fully connected, the works could not be completed. The extension of time clause allowed the contractor extensions for completion to the extent that overall or critical delay was caused by the default of the Wind Turbine Contractor.

Akenhead J noted that if overall or critical delay was caused by the contractor but individual turbines were delayed by the default of Wind Turbine Contractor (beyond the contractual completion date), there was no provision to alleviate the imposition of liquidated damages on the contractor. He reasoned therefore that the contractor could end up paying liquidated damages for delays caused by the Wind Turbine Contractor's default in completing its work on the turbines even though the parties had agreed that for critical or overall delay the contractor was not responsible.

He concluded that because it was clearly intended that the contractor was not to be responsible for the default of the Wind Turbine Contractor, the parties nonetheless agreed a liquidated damages clause which would impose such damages upon the contractor in foreseeable circumstances. He considered this situation to be penal.

On the other hand, where parties have provided for payment of intermediate amounts of liquidated damages for delay to parts of the works prior to completion of the entire works, courts reflect the modern approach to liquidated damages provisions by upholding such provisions as part of the commercial agreement, providing there is no substantial discrepancy between the amount of liquidated damages and the level of damages that could be sustained.

¹⁵ [2008] BLR 321.

In *Steria Ltd v Sigma Wireless Communications Ltd*,¹⁶ liquidated damages was levied against Steria in the event of delay in completion to each of three tasks under a sub-contract, regardless of whether or not they also delayed the last of the four tasks. Steria argued that this amounted to a penalty because it was impossible for Sigma to suffer any loss under the main contract unless the last of the four tasks was delayed. However, Davies J concluded that there was not necessarily a significant imbalance in every case, and was also influenced by the fact that both contracts contained caps on liquidated damages for delay, and therefore was not a case where Sigma was not passing on the benefit of a cap on liability to its subcontractor. In his conclusion, Davies J, consistent with the courts' modern approach to interpretation of liquidated damages provisions, emphasised the equal bargaining power of the parties, as follows:¹⁷

“Overall, this being a commercial contract entered into between two substantial and experienced companies with knowledge of the difficulties which can occur where after the event one party seeks to recover general damages from the other for delay, I am not prepared to strike down the clause as penal.”

In *Liberty Mercian Ltd v Dean & Dyball Construction Ltd*,¹⁸ a further recent construction case, the contract provided for sectional completion of four retail units in five phases and stipulated a liquidated damages amount in respect of each of the five phases, ranging in amounts from GBP1,500 to GBP12,000. The architect found that the contractor was responsible for four weeks of culpable delay in phase 1, and as a consequence of the delay in phase 1, each of the subsequent four phases was also delayed by four weeks. Liberty, the owner, sought to impose liquidated damages for four weeks for each of the five phases. Dean & Dyball argued that the liquidated damages provision constituted a penalty because the defendant was repeatedly penalised for the same delay by the deduction of liquidated damages in respect of each section, which it referred to as the “*cascade*” argument.

Coulson J held that the provisions were not a penalty, and referred to the result not giving rise to any unfairness:¹⁹

“...such a result cannot be regarded as unfair. On the contrary, if the contractor is in culpable delay for four weeks in relation to section 1, which inevitably means that section 2 is going to start four weeks late, so that the contractor's default has caused that delay to section 2, he should therefore be liable for the liquidated damages that would flow in consequence.”

He was also influenced by the fact that the amount of liquidated damages varied from one section to another, to reflect the different work involved in each section, and the different losses that would flow if one particular section was delayed. He said that this was:²⁰

“...strong support for the proposition that these sums do not represent a penalty, but are instead a genuine pre-estimate of the specific loss that would be suffered in the event that the particular section in question was delayed.”

¹⁶ [2009] BLR 79.

¹⁷ [2008] BLR 79, at para 106.

¹⁸ [2009] BLR 29.

¹⁹ [2009] BLR 29, at para 24.

²⁰ [2009] BLR 29, at para 25.

Dean & Dyball also did not provide any evidence that the stipulated amounts were excessive, and Coulson J did not himself assess the amount of stipulated damages.

3.0 Time at Large

The “*prevention principle*” operates to invalidate a liquidated damages clause where the owner causes completion of the works to be delayed, for example, by failing to give possession of the site, by failing to provide plans and specifications at the proper time, or by ordering additional work. This leaves the owner to prove his damages at large, and the contractor obliged only to complete the works within a reasonable time. The exception to the operation of the prevention principle is where the contract contains a clear and specific mechanism for extending time for owner-caused delays, and the owner or contract administrator has validly extended time.

The prevention principle is founded on the broader notion that a party cannot impose a contractual obligation if that party has prevented the other party from complying with the obligation. Lord Denning in *Amalgamated Building Contractors Ltd v Waltham Holy Cross UDC*,²¹ said: “*the building owner cannot insist on a condition if it is his own fault that the condition has not been fulfilled*”. Brooking J in *SMK Cabinets v Hili Modern Electrics Pty Ltd*²² described the prevention principle as being “*grounded upon considerations of fairness and reasonableness*”.

4.0 Extensions of Time

4.1 General Principles

Construction contracts invariably contain provisions for extension of the time for completion arising from specified events, and if an extension has been granted, this operates as a defence to a claim for liquidated damages from the original completion date.

Generally speaking, the specified events fall under two broad categories (a) delay events caused by the owner; and (b) neutral delay events not caused by the owner eg weather, strikes, force majeure etc.

4.2 Conditions Precedent to Extension of Time

Many construction contracts now provide that the contractor’s entitlement to an extension of time for completion is subject to the contractor serving upon the owner a notice of an event causing delay within a stipulated time period. Where such a provision is a condition precedent to an extension of time, a failure by a contractor to comply with the provision may deprive the contractor of an extension of time, and allow the owner to recovery liquidated damages.

There are no conceptual difficulties with the application of a condition precedent for notice of neutral delay events not caused by the owner. However, conceptual difficulties arise where the delay has been caused by the owner, and the contractor fails to comply with a condition precedent for an extension of time, because such provisions give rise to a tension between the owner’s

²¹ [1952] 2 All ER 452.

²² [1984] VR 391.

freedom to stipulate contractual notices and the prevention principle. This tension has given rise to a number of decisions, and conflicting academic debate on where the balance may lie.

In Australia, in *Gaymark Investments Pte Ltd v Walter Construction Group Ltd*,²³ the Supreme Court of Northern Territory held that in the absence of strict compliance with the conditions precedent to an extension of time, and where the contractor has been actually delayed by an act, omission or breach for which the owner is responsible, there is no provision for an extension of time, that is, time is at large, and the owner was not entitled to recover liquidated damages for delay. The editors of “*Keating on Construction Contracts*” referred to the decision in *Gaymark*, and supported the principle, as follows:²⁴

“It is thought that, in accordance with the doctrine of prevention or possibly as a matter of causation, the employer cannot be compensated for losses which he has brought about in the absence of express words to that effect.”

In contrast, the editor of “*Hudson on Building Contracts*”, Professor Duncan Wallace QC, considers *Gaymark* to be wrongly decided, and refers to the practical purpose of provisions requiring a contractor to give notice of delay, being to allow matters to be investigated while they are current.²⁵

Prior to the decision in *Gaymark*, it was thought that the Australian courts may have been prepared to resolve the tension in favour of the owner to avoid the consequence of the owner’s prohibition on recovery of liquidated damages as a result of the contractor’s failure to exercise a “*contractual right*”, as a result of the dicta of Cole J in the New South Wales Court of Appeal in *Turner Corporation Ltd v Austotel Pty Ltd*.²⁶

“If the Builder, having a right to claim an extension of time fails to do so, it cannot claim that the act of prevention which would have entitled it to an extension of time for Practical Completion result in its inability to complete by that time. A party to a contract cannot rely upon preventing conduct of the other party where it failed to exercise a contractual right which would have negated the affect of that preventing conduct.”

The decision in *Gaymark* was not followed by the New South Wales Court of Appeal in *Peninsula Balmain Ptd Limited v Abi Group Contractors Pty Limited*,²⁷ in which the court preferred the reasoning in *Turner Corporation* and Professor Duncan Wallace QC’s views expressed in “*Hudson on Building Contracts*” (although the court did not actually refer to the *Gaymark* decision).

Jackson J in the Technology and Construction Court in London, in *Multiplex Construction (UK) Limited v Honeywell Control Systems Limited (No 2)*,²⁸ more recently considered the decision in *Gaymark*. In *Multiplex*, Honeywell relied on *Gaymark*, arguing that its failure to comply with a

²³ [1999] NTSC 143.

²⁴ “*Keating on Construction Contracts*” (8th edition, 2006), at para 9-025.

²⁵ “*Hudson on Building Contracts*” para 10.026 of the first supplement to the 11th edition, and “*Prevention and Liquidated Damages: a Theory Too Far*” (2002) 18 BCL 82.

²⁶ (1994) 13 BCL 378 at pp 384-385.

²⁷ [2002] NSW CA 211.

²⁸ [2007] BLR 195.

condition precedent to an extension of time was sufficient to put time at large, otherwise, Multiplex would be able to recover damages for a period of delay which Multiplex had caused.

He referred to the conflicting academic debate as to whether *Gaymark* was correctly decided, and also referred to the decisions in *Peninsula*, and of the Second Division of the Inner House of the Court of Session in *City Inn Ltd v Shepard Construction*,²⁹ in which the court held that the contractor had to comply with any condition precedent to an extension of time before an extension of time application could be entertained.

Jackson J favoured the reasoning in of the Australian courts in *Turner* and *Peninsula*, and of the Inner House in *City Inn*. He also said that he saw “*considerable force in Professor Wallace’s criticisms of Gaymark*”, which he supported in his conclusion:³⁰

“Contractual terms requiring a contractor to give prompt notice of delay serve a valuable purpose; such notices enables matters to be investigated while they are still current. Furthermore, such notice sometimes gives the employer the opportunity to withdraw instructions when the financial consequences become apparent. If *Gaymark* is good law, then a contractor could disregard with impunity any provision making proper notice a condition precedent. At his option the contractor could set time at large.”

In any event, Jackson J distinguished the decision in *Gaymark* on the basis that in *Gaymark* non-compliance with the notice clause exposed the contractor to an automatic liability for liquidated damages, whereas in *Multiplex* no such automatic consequence arose.

Similarly, in Hong Kong, in *Hsin Chong Construction (Asia) Ltd v Henble Ltd*,³¹ Reyes J in the Hong Kong High Court rejected Hsin Chong’s argument that the prevention principle should operate to disentitle Henble from recovering liquidated damages where Hsin Chong had failed to provide notices of delay in accordance with the contract. Reyes J rejected the reasoning in *Gaymark*, preferring the reasoning of Professor Wallace QC in “*Hudson on Building Contracts*” referred to above.

Jackson J’s decision in *Multiplex* was followed by Mr Justice Stephen Davies’s decision in *Steria Ltd v Sigma Wireless Communications Ltd*,³² in which Steria had failed to provide Sigma with the requisite delay notices as a condition precedent to an extension of time under the subcontract, and argued that since Sigma’s actions had delayed Steria that time was at large.

Davies J noted that the court in *Multiplex* did not need to express a final decision on the point, on the particular wording of the provision, but he nonetheless adopted Jackson J’s analysis and agreed with his preliminary conclusion.³³

He described the “*commercial absurdity*” of an argument which would result in the contractor being better off by deliberately failing to comply with the notice condition than by complying with it. He also referred to the “*inconsistent and undesirable result*” of the notice provisions acting as a condition precedent in relation to delays caused by neutral events, but not for delays

²⁹ (2003) SLT 885

³⁰ At para 103.

³¹ [2006] HKCFI 965, 18 August 2006.

³² [2008] BLR 79.

³³ [2008] BLR 79, at para 95.

caused by the employer. He also referred to the contractor's right under the contract to recover extra costs in relation to the delay, and if so, that this would provide the contractor a benefit arising from its own breach, which "*is the converse of the prevention principle and hence might be said to be equally objectionable.*"³⁴

Davies J also rejected Steria's argument that *Multiplex* should be distinguished on the basis that unlike the provision in *Multiplex*, the relevant provision in the subcontract was not a "*clear and unambiguous notice condition precedent clause*". Although the provision was not expressed as a condition precedent to an extension of time, Davies J considered that the provision was sufficiently clearly drafted to have that effect (please refer to the discussion in Section 4.4 below concerning the wording of time bar provisions).

In both *Multiplex* and *Steria*, the issues were decided on other points, therefore the courts' observations on the *Gaymark* principle were technically *obiter dicta*. Whilst the courts emphasized the practical reasons from an employer's perspective for requiring the contractor to comply with its obligation to issue notices, and the anomalies which could arise if time goes at large as a consequence of the contractor's failure to do so, neither court discussed the potential anomalies on the contractor's side of the ledger.

First, from a causation perspective, it is the owner's acts of prevention which actually delays completion, not the contractor's failure to provide notices. Imposing the problem of such delays upon the contractor is a risk allocation which should require clear wording.³⁵

Secondly, extension of time provisions are to be construed *contra proferentem*, and it should require clear language to impose upon a contractor the risk of completing by the original contract completion date notwithstanding delays caused by the owner. Provisions which disentitle a contractor to an extension of time unless the contractor has issued a notice of delay apply to both delays caused by the owner, and to neutral delays for which a contractor is entitled to an extension of time. In the light of this, there is an argument that such provisions are not sufficiently clear to impose the risk of employer's delays upon the contractor.³⁶ Professor Jones argues that the parties could not have intended this outcome, and in Australia, this is reflected in standard forms which allow the superintendent to extend the time for completion notwithstanding that the contractor has not applied for an extension of time, and that the *Gaymark* decision arose as a consequence of the parties deleting this provision from a standard form.³⁷

In the author's view, the Australian standard forms allowing the superintendent to extend time for completion regardless of whether the contractor complies with a condition precedent provision effectively reconcile the competing arguments, because it allows liquidated damages provisions to remain operative, gives the owner the practical benefit of notice provisions as conditions precedent, as explained by Professor Wallace QC, and allows the superintendent to extend time only for delays caused by the employer.

In summary, notwithstanding the doubts on the application of the *Gaymark* principle, on the reasoning in *Multiplex* and *Steria*, contractors are likely to have limited potential to defend a

³⁴ [2008] BLR 79, at para 95.

³⁵ Jones D, "*Can Prevention be Cured by Time Bars*" [2009] ICLR 57, at p68.

³⁶ *Ibid*, at p68.

³⁷ *Ibid*, at pp68-69.

liquidated damages claim on the basis of their own failure to comply with any condition precedents to an extension of time for completion.

4.3 Inoperable Extension of Time Provisions

Some cases suggest that where the employer or his agent fails to operate the extension of time procedure, the effect may be to set time at large. In *Peak v McKinney*, Salmond LJ expressed as *obiter* the principle in the following terms:³⁸

“In any event, it is clear that, even if clause 23 had provided for an extension of time on account of the delay caused by the contractor, the failure in this case of the architect to extend the time would be fatal to the claim for liquidated damages. There had clearly been some delay on the part of the corporation. Accordingly, as the architect had not made ‘by writing under his hand such an extension of time’, there is no date under the contract from which the defendants’ liability to pay liquidated damages for delay could be measured. And therefore none can be recovered.”

It seems however that even where the employer or his agent fails to operate the extension of time machinery as intended, where the contract contains contractual machinery to establish the true position, such as by recourse to litigation or arbitration, the breakdown is immaterial, even where the contractor does not obtain the contractual right or benefit which would otherwise have been established.³⁹

Jackson J in *Multiplex* considered whether the extension of time machinery had become inoperable as a result of Multiplex’s conduct, and adopted a similar approach to the decision in *Bernhard’s Rugby Landscapes*. However, he did not go on to consider what the result would have been had he concluded that the extension of time machinery had broken down.

Honeywell argued that Multiplex, by failing to provide Honeywell with an updated programme and associated new completion date after it became apparent that the original completion date was not achievable, rendered the extension of time machinery in the contract inoperable because it was impossible for Honeywell to identify the critical path, or the extent of delay, and hence Honeywell could not comply with the delay notice requirements in the contract.

Jackson J acknowledged that there was some validity in this argument, but he rejected the argument on two grounds:

- (1) Honeywell’s obligations for giving delay notices under the terms of the sub-contract was not an absolute requirement to serve notices immediately, but only after delays became “*apparent*”, and to provide information “*if practicable*”.
- (2) The evidence was that Honeywell served such delay notices as it was possible, even though Honeywell could not ascertain the precise consequences in terms of delay at the stage of giving the notices. The judge concluded therefore that the extension of time machinery was both operable and was being operated by Honeywell.

Jackson J in *Multiplex* accepted that Multiplex had caused delay and should have issued new programmes with updated completion dates, but stated that this provided Honeywell with

³⁸ (1976) 1 BLR 111, at 121.

³⁹ *Bernhard’s Rugby Landscapes Ltd v Stockley Park Consortium Ltd* ((1997) 82 BLR 39).

justification for an extension of time as part of its claim in the litigation proceedings, but it was not the case that the extension of time machinery had broken down.

4.4 The Terms of Time Bar Provisions

In Australia there has been a number of cases where contractors have unsuccessfully argued that the written notice requirements for an extension of time do not operate as time bars in a number of Australian standard forms of construction contract, none of which expressly state that notice provisions are a condition precedent to an extension of time.⁴⁰

Partly as a result of the litigation in Australia, drafters of bespoke construction contracts now regularly expressly provide for contractors' notices to be a "*condition precedent*" to an extension of time. The FIDIC suite of contracts is an example of a standard form which also now expressly states that the contractor shall not be entitled to an extension of time unless he has issued an appropriate notice, for example, Sub-Clause 20.1 of the FIDIC "*Silver Book*":

"If the Contractor fails to give notice of a claim within such period of 28 days, the Time for Completion shall not be extended, the Contractor shall not be entitled to additional payment, and the Employer shall be discharged from all liability in connection with the claim."

As discussed above, Davies J in *Steria Ltd v Sigma Wireless Communications Ltd* considered the meaning of a notice provision which did not expressly state that it was a condition precedent to an extension of time. The provision stated:⁴¹

"...provided that the subcontractor shall have given within a reasonable period written notice to the contractor of the circumstances giving rise to the delay."

Steria argued that, applying the *contra proferentem* principle, the terms of the notice provision was not a condition precedent, since it did not expressly state that unless the notification provision is complied with, *Steria* will lose its right to an extension of time. Davies J rejected this argument, stating:⁴²

"In my opinion the real issue which is raised on the wording of this clause is whether those clear words by themselves suffice, or whether the clause also needs to include some express statement to the effect that unless written notice is given within a reasonable time the subcontractor will not be entitled to an extension of time.

In my judgment a further express statement of that kind is not necessary. I consider that a notification requirement may, and in this case does, operate as a condition precedent even though it does not contain an express warning as to the consequence of non-compliance."

Notwithstanding the result in *Steria*, as proposed by Professor Jones, there is an argument that the terms of the notice provision were not sufficiently clear to have the effect of requiring the

⁴⁰ Refer to *Opat Decorating Service (Aust) Pty Ltd v Hansen Yunken (SA) Pty Ltd* (unreported?), *Diploma Constructions v Rhodgkin Pty Ltd* (1995) 11 BCL 242, *Wormald Engineering Pty Ltd v Resources Conservations Co International* (1989) 8 BCL 158, *Queensland v Multiplex Constructions Pty Ltd* (1998) 14 BCL 247, and *Australian Development Corporation Pty Ltd v White Constructions (ACT) Pty Ltd* (1996) 12 BCL 317.

⁴¹ [2008] BLR 79, at para 90.

⁴² *Ibid*, at para 85.

contractor to complete by a fixed date, notwithstanding being delayed by an owner, applying the principle in *Dodd v Churton*:⁴³

“...require very clear language to shew that a man has undertaken a responsibility which very few men would undertake with their eyes open.”

5.0 Limits of General Damages for Delay

5.1 Introduction

If a party is successful in arguing that the liquidated damages provision in the contract is unenforceable either:

- (1) because the provision is held to be a penalty; or
- (2) because “*time is at large*”,

an issue arises as to whether that party’s general damages is limited by the specified liquidated damages provisions in the contract.

5.2 Unenforceable by Reason of Penalty

In cases where a stipulated sum is an unenforceable penalty, in most cases the stipulated sum is a penalty because the sum is “*extravagant and unconscionable*” in amount in comparison with the greatest loss that could be proved to have flowed from the breach. As such, there is rarely a practical issue as to whether the unenforceable penalty clause would nonetheless operate as a limit on the amount of general damages. However, it is theoretically possible for general damages to be greater than the stipulated unenforceable penalty.⁴⁴

In a construction context, the issue was referred to by Lord Atkin in *Cellulose Acetate Silk Co Ltd v Widnes Foundry (1925) Limited*, where the court held that the stipulated weekly damages was not a penalty, and stated:⁴⁵

“In these circumstances I find it unnecessary to consider what would be the position if this were a penalty. It was argued by the appellants that if this were a penalty they would have an option either to sue for the penalty or for damages for breach of the promise as to time of delivery. I desire to leave open the question whether, where a penalty is plainly less in amount than the prospective damages, there is a legal objection to suing on it, or in a suitable case ignoring it and suing for damages.”

In *Robophone Facilities Ltd v Blank*, Lord Diplock also referred to this issue, but again left it open:⁴⁶

⁴³ [1897] 1 QB 582, at p589. Refer also to Jones D, “*Can Prevention be Cured by Time Bars*” [2009] ICLR 57, at p68.

⁴⁴ As noted by the Supreme Court of Canada in *Elsely v J G Collins Insurance Agencies Ltd* (1978) 83 DLR (3rd) 1).

⁴⁵ [1933] AC 20 (HL), per Lord Atkin, at p26.

⁴⁶ [1966] 1 WLR 1428, at pa 1446.

“...in *Cellulose Acetate Silk v Windes Foundry* Lord Atkin expressly left open the question whether a penalty clause in a contract, which fixed a single sum as payable upon 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.”

However, the Supreme Court of Canada in *Elsely v J G Collins Insurance Agencies Ltd*⁴⁷ expressly considered the issue of a limit on general damages in the context of an unenforceable penalty of \$1000 in an employment contract. The court noted that the House of Lords in *Cellulose Acetate Silk Company Limited v Widnes Foundry (1925) Limited* left open the question. However, the court reasoned that the unenforceable penalty will continue to be enforced as an upper limit on any damages claimed, whether the liquidated damages clause survives or not, as follows:⁴⁸

“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 being ineffective to increase the damages above the actual loss sustained when such loss is less than the stipulated amount.

...

In the context of the present discussion of the measure of damages, the result is that an agreed sum payable on breach represents the maximum amount recoverable whether the sum is a penalty or a valid liquidated damages clause.”

In support of this, the court also said earlier in the judgment:

“In addition, if the parties have agreed on a set amount of damages at law, or a maximum amount, it would be unconscionable, in my opinion, to allow recovery of a greater amount of damages in equity.”

The court’s reasoning in *Elsely* has been applied in subsequent Canadian cases, by the Court of Appeal of British Columbia in *Fraser v Van Nus*,⁴⁹ the Court of Appeal of Ontario in *Ossory Canada Inc v Wendy’s Restaurants of Canada*,⁵⁰ and by the Court of Queen’s Bench for Saskatchewan in *Lac La Ronge Indian Band v Dallas Contracting Ltd*.⁵¹

Mason and Wilson JJ, in the Australian High Court, in *AMEV-UDC Finance Ltd v Austin*,⁵² subsequently referred to the decision in *Elsley*, but expressly left open this question:

“The question whether a penal provision is void or unenforceable has been the subject of continuing debate. There has also been a conflict of authority on the related question whether a penalty operates to impose a limit on the common law damages which a plaintiff may recover. The

⁴⁷ (1978) 83 DLR (3rd) 1.

⁴⁸ *Ibid*, at p15.

⁴⁹ CA005891, 10 June 1987.

⁵⁰ (1997) 36 OR (3rd) 483.

⁵¹ [2001] SKQB 135.

⁵² (1986) 163 CLR 170.

charterparty cases say that the plaintiff may ignore the penalty and sue for greater damages (Wall v. Rederiaktiebolaget Luggude (1915) 3 KB 66; Watts, Watts and Company, Limited v. Mitsui and Company, Limited (1917) AC 227), but there is also authority the other way (Wilbeam v. Ashton (1807) 1 Camp 78; 170 ER 883; Lord Elphinstone v. Monkland Iron and Coal Co. (1886) 11 App. Cas. 332, at p 346; Public Works Commissioner v. Hills (1906) AC 368, at p 376). The point was left open by Lord Atkin in Cellulose Acetate Silk Co. v. Widnes Foundry (1925) Ltd (1933) AC 20, at p 26, and by Diplock L.J. in Robophone Facilities Ltd v. Blank, at p 144; p 142 of All ER; but cf. Financings Ltd v. Baldock, at p 121. Since then the question has attracted different answers from the Supreme Court of Canada in *Elsley v. J.G. Collins Insurance Agencies Ltd* (1978) 83 DLR(3d) 1 and from Lee J. in *W & J Investments Ltd v. Bunting* (1984) 1 NSWLR 331. It is unnecessary for the purposes of determining the present case to resolve the larger aspects of this controversy.”

The leading English construction commentators support the reasoning in *Elsley*. The editor of “*Hudson’s Building and Engineering Contracts*”, Professor Duncan Wallace QC, refers to the decision in *Elsley*, as follows:⁵³

“The very important case of *Elsley v Collins Insurance* in the Supreme Court of Canada...resolves a major uncertainty and shows persuasively that, where a clause is not for this reason a pre-estimate of the likely damage, it will nevertheless continue to be enforced as an upper limit on any damages claimed, whether the liquidated damages clauses survives or not.”

Similarly, the editors of “*Keating on Construction Contracts*” views are:⁵⁴

“It is submitted that it would be inequitable to permit an employer to impose an excessive liquidated damages clause in terrorem and then to avoid its effect in order to recover more. Further, where the nature of the clause is usually, as is suggested above, to limit the contractor’s liability, there is every reason why the contractor should not be denied that limitation simply because the employer’s estimate of his loss was not genuine.”

More recently, in *Riggall v Thompson*, the Queensland Court of Appeal held a liquidated damages provision to be unenforceable as a penalty, and held that general damages were recoverable, describing these in the following terms:⁵⁵

“It is clear that a conclusion that a liquidated damages clause is unenforceable as a penalty does not preclude recover of damages in such lesser amount as reflects the plaintiff’s action loss.”

It is not clear whether the court considered that the unenforceable penalty operated as a legal limit on recovery of general, or whether the was simply stating the practical consequence of deciding that usually the general damages is less than, since this is the very reason for striking down the penalty provision.

In some charter party cases, English courts have found a stipulated damages provision to be an unenforceable penalty, but then disregarded the penalty to permit the innocent party to recover its actual loss, whether more or less than the sum stipulated in the penalty clause. However, these

⁵³ *Hudson’s Building and Engineering Contracts* (11th edition), at para 10.022.

⁵⁴ 8th edition, 2006, at para 9.014.

⁵⁵ [2010] QCA 144 (11 June 2010).

cases have been explained in later cases to turn upon the fact that there was one clause purporting to fix one damage for every sort of breach (*Windes Foundry v Cellulose Acetate Silk Co*⁵⁶).

This explanation of the charter party cases is consistent with general principles, since in circumstances where courts have found a penalty to be unenforceable by reason of it not being a genuine pre-estimate of loss by reason of the stipulated amount being excessive, the innocent party's general damages should be less than the stipulated sum for the same breach in any event. The charter party cases should be regarded as a special case.

5.3 Unenforceable by Reason of Time at Large

In circumstances where the liquidated damages clause is unenforceable by reason of time being "at large", there is no authority directly on whether the liquidated damages amount is an enforceable upper limit on any damages. The issue was referred to in *Rapid Building v Ealing Family Housing*, where Stephenson LJ stated:⁵⁷

"It is accepted that a party must elect whether to claim liquidated or unliquidated damages; but as it seems to me, where the claim for liquidated damages has been lost or has gone, as has been rightly held by the judge, the defendants are not precluded from pursuing their counterclaim for unliquidated damages. It is not accepted on behalf of the defendants that if they pursue their claim it has on it a ceiling equal to the amount of liquidated damages. It do not find it necessary to decide that point, because the other two submissions made by Mr Wilmot-Smith are wrong."

The principle set out in *Elsely* of limiting general damages to the amount of the unenforceable penalty, applies equally to the case where a genuine pre-estimate of loss stipulated as liquidated damages is inoperable because time is at large. Indeed, the argument is stronger in the latter situation because parties generally stipulate liquidated damages for delay as a means of limiting a contractor's liability for delay damages, and an owner could therefore benefit from its own breach by recovering general damages greater than stipulated liquidated damages by its own act of prevention.

6.0 Cap on Liquidated Damages for Delay

In addition to liquidated damages for delay expressed per a time period, construction contracts often contain provisions capping the amount of liquidated damages for delay as a fixed percentage of the contract price. The question arises as to whether these provisions continue to operate as a cap on damages for delay if the liquidated damages clause is unenforceable as a penalty or by reason of time being at large.

There is no decision on this issue, but Mr Justice Stephen Davies in *Steria Ltd v Sigma Wireless Communications Ltd*⁵⁸ expressed an *obiter* view on this issue. In that case, the provisions of sub-contract capped liquidated damages for delay at 10% of the sub-contract price. Davies J upheld the liquidated damages provisions, but expressed an *obiter* view as to whether the cap on liquidated damages would continue to operate, as follows:⁵⁹

⁵⁶ [1931] 2 KB (CA).

⁵⁷ (1984) 29 BLR 5 (CA), at p9.

⁵⁸ [2008] BLR 79

⁵⁹ [2008] BLR 79, at para 113.

“If I had needed to decide the point, I would have inclined to the view that if the liquidated damages provision is held to be penal, then it prevents either party from relying on it, so that the cap also disappears.”

With due respect to Davies’ J judgment, it seems to the author that there is a conceptual difference between a daily or weekly rate of liquidated damages and a contractual cap on such damages. The former is an attempted expression of the parties’ genuine pre-estimate of daily or weekly losses, and if this provision is unenforceable, it is arguably only this aspect of the provision which is affected. The latter, on the other hand, is intended to operate as an overall risk allocation for total damages for delay, expressed as a percentage of the total contract price, whether such damages are measured as liquidated damages for delay or general damages for delay.

In addition, the reasoning in *Elsley* of the unconscionably of allowing a party to recover an amount greater than an unenforceable penalty expressed as a daily or weekly rate of liquidated damages, applies equally to an overall cap on liquidated damages expressed as a percentage of the contract price. If Davies J’s obiter view is correct, it could lead to the anomalous situation of the employer benefiting from a penalty by recovering general damages for delay significantly greater than the contractual cap for liquidated damages for delay.

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