

A LEGAL COMMENTARY ON THE POSITION OF LIQUIDATED ASCERTAINED DAMAGES IN THE UNITED KINGDOM

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ABSTRACT

The purpose of this paper is to consider the various aspects of a liquidated agreed damages clause (LAD) in contracts, from the perspective of recent English case-laws in the United Kingdom. The focus is on the law on penalty generally in terms of its principles and criteria that are needed for a clause to be a valid LAD clause, the rationale for parties to agree to such a LAD clause and the effects of a LAD clause in a contract. The definition, use and implication of exclusion clauses and limitation clauses are also considered. The purpose of this paper is moreover to focus the mind of contracting parties on the legal considerations as to the nature and effect of such clauses. Better understanding of the legal implications of such clauses would place the parties in a better position to negotiate and protect their own interests. Recommendations and safeguards are suggested for the benefit of the contracting parties.

INTRODUCTION.

When parties enter into a contract there are rights and obligations which are vested upon the parties. Breach of contract means that the party (hereinafter referred to as the defaulting party) to a contract does not fulfill an obligation under the contract. Upon the breach or non fulfillment of an obligation by the defaulting party the innocent party has always the remedy of damages.¹ To recover damages however, the innocent party has to sue for breach of contract and has the evidentiary burden to adduce proof under the principle of law as set out under *Hadley v Baxendale* (1854) 9 Exch341.²

However if the parties agree at the time of contract that a certain sum of money is payable

in the event of breach of a particular obligation under contract, the said sum is termed as a liquidated agreed damages clause (LAD). The LAD is based on a genuine pre-estimate of the loss, assessed at the time of contract, which would arise as a result of the breach of contract and quantified at a certain sum payable in event of the breach.

The said sum may be set off³ against monies due to the defaulting party without having to sue for breach of contract. In the event there are no monies due to the defaulting party, the innocent party may sue for recovery of the LAD without having to discharge the evidentiary burden of proof of loss. However the said LAD clause may be challenged by the defaulting party as a penalty and may be treated as invalid if it is found to be a penalty. This paper intends to include discussion on:

1. The definition of LAD clauses, limitation of liability clauses and exclusive remedy clauses.
2. The rationale and effect of agreeing to a LAD clause with reference to presumptions created and the evidentiary burden of proof.
3. Charting the development of the test or criteria applied by the courts in deciding whether the LAD is a valid LAD or a penalty.

DEFINITION AND TYPES OF LAD CLAUSES.

A liquidated ascertained damages clause (LAD) is a clause in a contract that fixes an agreed amount or an amount to be derived from an agreed formula to be paid by the defaulting party in the event of a breach. The liquidated ascertained damages may include those damages that flow naturally and directly as a result of the breach of contract and also consequential damages that do not flow directly from the breach of contract but were within the reasonable contemplation of the

parties at the time of contract. Two examples of LAD clauses are as follows:

1. Delay Liquidated Damages (DLD).

The purpose of DLD is to compensate for loss and damage suffered as a result of late completion of the contract. Usually DLD are calculated based on the extra charge per day of delay which in turn is based on the extra cost and loss incurred⁴ as a result of the project not being completed on time.

2. Performance Liquidated Damages (PLD).

The purpose of liquidated damages here is to compensate for underperformance of the plant or facilities contracted for. The relevant performance guarantee may be with regard to efficiency, output, performance specification or availability.⁵

DEFINITION AND EFFECT OF AN EXCLUSIVE REMEDY CLAUSE.

Another question that warrants consideration is whether a LAD clause is drafted as an exclusive remedy clause. An exclusive remedy clause is one where the parties agree to make the remedy stated under the contract as the only remedy available to the parties. The parties cannot sue for or pursue a remedy other than that stated in the contract.

In *Decoma UK Limited v Haden Drysys International Ltd* [2005] EHWCB12, Decoma made a claim for damages in excess of 18 million pounds for breach of contract arising from defects in the paint-spraying system designed, built and installed by Haden for Decoma facility. The contract between parties was a negotiated contract and the contract price was for 8,738.799 million pounds. In response to the claim by Decoma for damages, Haden relied on the contract terms which, in varying ways, limit or exclude their liability for damages. On the facts of the case, due to the breaches of contract by Haden, substantial completion as defined in the contract was never achieved and as result there had never been Final Acceptance of Haden paint-spraying system. The issue of the LAD clause being an exclusive remedy clause and the effect of a limitation clause both arose for the court's consideration.

Haden relied upon Article 12.3 which concerned Liquidated and Ascertained Damages. The said clause can be found on page 12 of the judgment of Judge Peter Coulson QC on para 39,

"Article 12.3 was the provision concerned with Liquidated and Ascertained Damages. Such damages were payable if Haden failed to achieve the Final Completion Date and ascended on a rising scale to a maximum amount of 5% of the Contract Price'. The deduction and payment of the liquidated damages were said to be: '...In full satisfaction and accord of the Contractor's liability to achieve Final Acceptance by the Final Completion Date. Both parties are agreed that the aforementioned rates are a genuine pre-estimate of loss." (Emphasis added).

The learned judge also on page 14 considered Article 12.4 which was titled 'Limitation of Liability' which was divided in four parts, wherein the second part reads,

"Further, damages for any breach of this Agreement by the Contractor prior to Final Acceptance Certification, shall expressly not exceed, in aggregate to any payments that shall become payable under Article 12.3, the maximum amount of 5 % of the Contract Price...and such liability or payment shall be in full satisfaction and accord of the Contractor's liability for the said failure..."

The fourth part found in this same page further states that:

"Any exclusion or limitation of liability under this Agreement shall exclude or limit such liability in contract, tort, or otherwise."

Should Haden's contention be correct, Decoma's entitlement would most likely be limited to 5% of the contract price. The learned judge considered arguments on these legal questions as preliminary questions and found merits in Haden's arguments.

It was sought to be argued that Decoma could have a claim for losses suffered prior to Final Acceptance that was not covered by the LAD