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Liquidated damages: know the law or pay the price

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Liquidated damages clauses are a key provision in shipbuilding and offshore construction contracts. They provide certainty as to the amount of money that will be paid as damages in the event of delays to delivery or failure to meet specified performance criteria regardless of the loss actually suffered. Not only do they fix in advance the damages that will be payable, they also serve to limit a contractor's exposure. What happens though when the contract is terminated prior to completion but after liquidated damages fall due? Is the contractor obliged to pay those liquidated damages that have already accrued or does the liquidated damages clause no longer apply, with damages being assessed on the normal basis? This was the issue that fell to be decided by the Supreme Court in *Triple Point Technology, Inc v. PTT Public Company Ltd*[1] in relation to a software agreement.

The decision also looked at the limitation of liability clause and considered the meaning of "negligence" in such a clause and whether the liquidated damages were subject to a cap contained in the clause.

Facts

On 8 February 2013, PTT ("the Employer"), a Thai company that trades in oil and gas, entered into a contract with Triple Point Technology ("the Contractor"), a US-based company that specialises in the development and implementation of commodities trading software. Under the terms of the contract, the Contractor was to design, install, maintain and licence software to enable commodity trading. The total price of US$6.92m, was to be paid in instalments upon the achievement of nine "milestones".

Work under the contract began in March 2013 but the Contractor failed to meet the contractual timetable and a dispute arose over the payments due. The Contractor suspended work in May 2014 and in March 2015, the Employer terminated the contract, at which stage, only the first two payment milestones had been achieved. Proceedings were commenced by the Contractor to claim sums it alleged were due in respect of software licence fees; the Employer said that those monies were not due because the relevant milestones had not been met and counterclaimed for wasted costs in respect of hardware purchased prior to termination, liquidated damages up to the date of termination and, as termination loss, the costs of procuring a replacement system plus interest. As well as denying these claims, the Contractor relied on the cap in article 12.3 of the contract as limiting the damages claimed by the Employer.

Liquidated damages

The contract contained a liquidated damages clause, article 5.3, which provided that:

> "*If CONTRACTOR fails to deliver work within the time specified and the delay has not been introduced by PTT, CONTRACTOR shall be liable to pay the penalty at the rate of 0.1% (zero point one percent) of*

[1] [2021] UKSC 29

> *undelivered work per day of delay from the due date for delivery up to the date PTT accepts such work….”*.

The main issue for determination by the Supreme Court was whether liquidated damages were payable when, as a result of termination, the Contractor never completed the work.

While at first instance, the Technology and Construction Court[2] had accepted that liquidated damages were due for delay in respect of the period up until termination, even though the Contractor had never completed the work, the Court of Appeal[3] disagreed. It considered that article 5.3 focused specifically on delay between the contractual completion date and "*the date* [the Employer] *accepts such work*". As the Contractor had never handed over the completed work, the Court of Appeal found that the liquidated damages clause did not apply, and that the Employer would have to bring a claim for their actual losses related to delay assessed on normal principles.

The Supreme Court unanimously overturned the Court of Appeal's judgment on the interpretation of the liquidated damages clause, finding that the Court of Appeal had departed from the "*generally understood position*". The Court of Appeal had identified three possible interpretations based on previous case law which were reviewed by the Supreme Court:

1. that the liquidated damages clause does not apply at all[4];
2. that liquidated damages are payable up to the point of termination[5];
3. that liquidated damages are payable until the second contractor achieves completion[6].

The Court of Appeal had found that the first interpretation applied because, in its view, there was force in the reasoning of the House of Lords in *British Glanzstoff*. This was rejected by the Supreme Court, who distinguished the case and found that it did not create a special rule applying to liquidated damages clauses. Lady Arden, who gave the leading judgment, found this interpretation was "*inconsistent with commercial reality and the accepted function of liquidated damages*". As she explained, when negotiating a contract "*parties agree a liquidated damages clause so as to provide a remedy that is predictable and certain for a particular event*", commonly payment of a set daily amount in the event of a delay in completion. Lord Leggatt, who also gave a judgment, noted that adopting the Court of Appeal's interpretation would act as an incentive to a contractor who fails to meet the delivery date to not complete the works and therefore prevent the employer from accepting it to avoid paying liquidated damages.

The Supreme Court found that the second interpretation applied here. The Court of Appeal had acknowledged that this was the orthodox approach, but had been rejected it because "*if a construction contract is abandoned*

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[2] [2017] EWHC 2178 (TCC)

[3] [2019] EWCA Civ 230

[4] *British Glanzstoff Manufacturing Co Ltd v General Accident, Fire and Life Assurance Co Ltd* [1913] AC 143

[5] *Shaw v MFP Foundations and Pilings Ltd* [2010] EWHC 1839 (TCC)

[6] *GPP Big Field LLP v Solar EPC Solutions SL* [2018] EWHC 2866 (Comm)

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or terminated, the employer is in new territory for which the liquidated damages clause may not have made provision"; the Supreme Court did not agree. They did not consider that the clause required acceptance of the work for it to apply. The "orthodox approach", which the Supreme said "*parties must be taken to know*", provides that the accrual of liquidated damages comes to an end on termination of the contract and thereafter a party is entitled to seek damages for breach of contract under the general law. While parties may choose to specifically address the issue in their contract, Lady Arden made it clear that: "*parties do not have to provide specifically for the effect of the termination of their contract. They can take that consequence as read*…. *The territory is well-trodden…*".

As to the third interpretation, the Court of Appeal had doubts that such a situation would normally arise as much would depend upon the wording of the liquidated damages clause in question and as a result this received little attention in the Supreme Court.

In light of its comments on *British Glanzstoff*, the Supreme Court also sounded a note of caution on relying on the interpretation of similar clauses in previous cases. The Supreme Court indicated that parties would not be bound by the interpretation of the courts in reported cases involving similar wording unless it was "*some market-accepted wording or clauses from some standard form recognised in the industry*".

Negligence

The Supreme Court was then asked to decide if damages for the Contractor's negligent breach of the contract fell within an exception to the limitation on liability. Article 12.1 of the contract contained a contractual duty of care: "*CONTRACTOR shall exercise all reasonable skill, care and diligence and efficiency in the performance of the Services under the Contract and carry out all his responsibilities in accordance with recognized international professional standards. [...]".* It then went on, in article 12.3, to limit the extent of the Contractor's liability for any damage for breach of contract to the contract price received by the Contractor but added that this cap did not apply "*to CONTRACTOR's liability resulting from fraud, <u>negligence, gross negligence or wilful misconduct</u> of CONTRACTOR*".

The majority of the Supreme Court found that negligence has an accepted meaning in English law and covers both the separate tort of failing to use due care and a breach of a contractual provision to exercise due skill and care. Here the contract drew a distinction between services in respect of which the Contractor was to do or provide as an absolute covenant and those which were subject to an express contractual duty of skill and care. The Supreme Court therefore rejected the lower courts' conclusion that negligence in article 12.3 must mean "some independent tort". In circumstances where the parties could not identify a realistic example of an independent tort, the majority of the Supreme Court did not accept this limited interpretation of negligence but found that negligence included negligent breach of contract. As a result, liability for such damages were, in their view, uncapped under the contract. The dissenting opinion of Lord Sales and Lord Hodge accepted the interpretation of negligence adopted by the lower courts which limited the exclusion to tortious negligence.

Lord Leggatt observed that there has been a marked change in the approach of the English courts to the interpretation of exclusion and limitation clauses in the last 50 years and confirmed that the current approach is to "*recognise that commercial parties are free to make their own bargains and allocate risks as they think fit, and that the task of the court is to interpret the words used fairly applying the ordinary methods of contractual interpretation*". He also acknowledged that "*the court in construing the contract starts from the assumption that in the absence of clear words the parties did not intend the contract to derogate from these normal rights and obligations*."

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This divergence of opinion serves as a warning to parties when drafting limitation clauses to ensure such clauses are clearly drafted and in a manner which do not rely on context from other clauses.

Comment

Following a period of uncertainty, the Supreme Court's decision provides much need clarity to commercial parties as to the operation of liquidated damages clauses after a contract has been terminated. While it serves as a general warning to contracting parties that the court will expect them to know the general law, it confirms that, unless a contract provides to the contrary, the accrual of liquidated damages comes to an end on termination of the contract.

When it comes to shipbuilding contracts, it is worth noting that such contracts commonly do provide to the contrary when it comes to liquidated damages on termination. For example, article III.5 of the SAJ Form expressly provides that where a buyer rescinds the shipbuilding contract as a result of delay or deficiency in the specified performance criteria, "*the buyer will not be entitled to any liquidated damages*", even for the period between the delivery date and the date of termination. Instead on termination, a buyer would be refunded the installments of the contract price already paid, with interest thereon. As there is no such provision in the LOGIC Marine Construction Form, the contractor would be liable to liquidated damages up to the date of termination as well as the company's reasonably incurred additional costs which are a direct result of the termination.

In terms of the definition of negligence under English law, the Supreme Court has stated that this can incorporate both a breach of the contractual provision to exercise skill and care and tortious acts unless clear words to the contrary are used.

If parties wish to contract on a different basis in terms of liquidated damages or exclusion and limitation on liability clauses, then careful drafting and very clear words are required by the English courts.

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