October 5, 2022

"The cheque is in the mail: Liquidated Damages and the rule against penalties updated"

By Robert Blackett

Eco World - Ballymore Embassy Gardens Company Ltd v *Dobler UK Ltd* [2021] EWHC 2207 (TCC) and *Buckingham Group Contracting Ltd* v *Peel L&P Investments and Property Ltd* [2022] EWHC 1842 (TCC) are two recent first instance decisions which are useful on the question of whether, if an agreed damages clause is unenforceable, and the innocent party has to prove their real loss, the agreed damages amount will serve as a cap on the damages which may be recovered at common law.

Agreed damages clauses

Contracts routinely contain agreed damages clauses specifying what damages will be payable if the contract is breached. Thus, in a construction or similar contract, if the work is not completed by a promised date, the contractor agrees to pay the employer a certain amount each day or week until it is. A benefit of such clauses is that the employer need not spend time and money investigating and proving the real loss they have suffered, and avoids any arguments about whether loss is too remote or could have been mitigated, leading to a faster, cheaper resolution.

Why might an agreed damages clause be unenforceable?

Broadly, there are two ways in which an agreed damages clause might be unenforceable:

- it might be so vague or contradictory as to be inoperable and void for uncertainty;
- it might be a penalty.

Where an agreed damages clause is rendered unenforceable by either of these routes then the employer must prove their true loss. Typically a contractor will seek to attack an agreed damages clause, because it believes that the employer's real loss is less than the agreed damages. Sometimes, however, the contractor who succeeds in defeating an agreed damages clause will prove to have underestimated the employer's real loss. Less commonly, an employer will seek to attack an agreed damages clause, because it has suffered, and wishes to claim, a greater loss. In each case, the question may arise as to whether the agreed damages serve as a cap on the employer's recovery.

Uncertainty

For an agreed damages clause, like any other contractual provision, to be binding, it needs to be certain. The court's aversion for finding contracts, or provisions contained in them, to be void for uncertainty was summarised by O'Farrell J in *Vinci Construction UK Ltd* v *Beumer Group UK Ltd* [2017] EWHC 2196, TCC at [47] to [49]:

> *"[47] The courts are reluctant to hold a provision in a contract void for uncertainty, particularly where the contract has been performed: Anangel Atlas Compania Naviera SA v Ishikawajima-Harima Heavy Industries [1990] 2 Ll.Rep. 526 per Hirst J pp. 545-546:*

… the Court will strive if possible not to find a contract or contractual provision uncertain; indeed such a conclusion has been graphically described as a "counsel of despair" (Nea Agrex SA v Baltic Shipping Co Ltd., [1976] 2 Lloyd's Rep. 47 at p.50; [1976] 1 QB 933, at p.943, per Lord Denning, MR).

An important and well-recognised distinction must be drawn between conceptual uncertainty on the one hand, which invalidates the instrument, and evidential uncertainty, which merely means that a party may on a given set of facts be unable to establish that he comes within a particular aspect of the provision in question …"

See also*: Whitecap v John H Rundle [2008] EWCA Civ 429 per Moore-Bick LJ at para.21:*

""The conclusion that a contractual provision is so uncertain that it is incapable of being given a meaning of any kind is one which the courts have always been reluctant to accept, since they recognise that the very fact that it was included demonstrates that the parties intended it to have some effect.

[48] If it is open to the court to find an interpretation that will give effect to the parties' intentions, then it will do so: GLC v Connolly [1970] 2 QB 100 per Lord Denning MR at p.108; per Lord Pearson at p.110; Scammell v Dicker [2005] EWCA Civ 405 per Rix LJ at paras. [30] and [39]:

… it is simply a non sequitur to argue from a disagreement about the meaning and effect of a contract to its legal uncertainty. Parties are always disagreeing about the contracts which they make. They take those arguments, if necessary, to the courts, or to arbitration, for their resolution: and sometimes the resolution is very difficult indeed to arrive at. That is equally true of disputes as to the meaning of contracts and of disputes as to the application of contracts to the facts and of disputes as to the proper understanding of the facts. None of that makes a contract uncertain. For that to occur - and it very rarely occurs - it has to be legally or practically impossible to give to the parties' agreement any sensible content…

… that is certain which can be rendered certain …

[49] However, a provision in a contract will be void for uncertainty if the court cannot reach a conclusion as to what was in the parties' minds or where it is not safe for the court to prefer one possible meaning to other equally possible meanings: Arnhold & Co Ltd v Attorney General of Hong Kong (1989) 47 BLR 129 per Sears J. p.136."

The penalty rule

The common law generally permits people to make whatever agreements they want and holds them to what they have agreed. Thus, according to Lord Neuberger in *Arnold* v *Britton & Ors* [2015] UKSC 36 at [20]: "*The purpose of interpretation is to identify what the parties have agreed, not what the court thinks that they should have agreed. … it is by no means unknown for people to enter into arrangements which are ill-advised … and it is not the function of a court when interpreting an agreement to relieve a party from the consequences of his imprudence or poor advice. Accordingly, when interpreting a contract a judge should avoid re-writing it in an attempt to assist an unwise party or to penalise an astute party*".

The glaring exception, of course, is the 'penalty rule'. Rather than trusting people to decide for themselves how much they are willing to pay on breach and holding them to that, the common law will occasionally step in and deem the damages which a party has agreed to pay on breach to be excessive and refuse to enforce them. A detailed discussion of the penalty rule is beyond the scope of this article, but the leading case on the penalty rule remains *Cavendish Square Holding BV* v *Talal El Makdessi* [2015] UKSC 67, a decision of the Supreme Court.

A clause is a penalty if it seeks to impose on a party in breach of contract a detriment which is "*out of all proportion*", "*extravagant*", "*exorbitant or unconscionable*" relative to the other party's legitimate interest in the performance of the contract, judged at the time of contracting.

Prior to *Cavendish*, the leading case had been *Dunlop Pneumatic Tyre Co Ltd* v *New Garage and Motor Co* [1915] AC 79 in which Lord Dunedin had said that the test for a penalty was whether the agreed amount of damages was a 'genuine pre-estimate' of the damage that the innocent party would suffer as a result of the breach. In *Cavendish*, their Lordships said that this test will still "… *usually be perfectly adequate*" to determine the validity of an agreed damages clause.

The penalty rule in practice

It is hard to say quite what the practical effect of the penalty rule is. The Supreme Court in *Cavendish* stressed that there is a strong presumption of upholding agreed liquidated damages in the commercial context:

> *"… in a negotiated contract between properly advised parties of comparable bargaining power, the strong initial presumption must be that the parties themselves are the best judges of what is legitimate in a provision dealing with the consequences of breach."*

None of the clauses which were analysed in *Cavendish* itself was held to be a penalty. In the seven years since *Cavendish* was decided, penalty arguments have been raised in at least 18 first instance TCC or Commercial Court cases, and in none of those has a clause been struck down as a penalty (see the table below). But it is impossible to know whether that is because: (i) the threshold for a penalty is set so high that the rule is largely irrelevant; or (ii) that the penalty rule has a stifling effect, causing people to be very conservative in their drafting and routinely set agreed damages which are lower than would have been the case in an unregulated market.

1	*Zoom Investments Holdings Plc v Konkola Copper Mines Plc* [2017] EWHC 3288 (Comm)	The provision was not a penalty.
2	*GPP Big Field LLP & Anor v Solar EPC Solutions SL* [2018] EWHC 2866 (Comm)	The provision was not a penalty.
3	*Cargill International Trading PTE Ltd v Uttam Galva Steels Ltd* [2019] EWHC 476 (Comm)	The provision was not a penalty.
4	*ICICI Bank UK Plc v Assam Oil Co Ltd & Ors* [2019] EWHC 750 (Comm)	The provision was not a penalty.
5	*Longulf Trading (UK) Ltd v Niyazi Onen Gida SAN AS & Anor* [2019] EWHC 1573 (Comm)	The provision was not a penalty.
6	*School Facility Management Ltd & Ors v Governing Body of Christ the King College & Anor (Rev 1)* [2020] EWHC 1118 (Comm)	The provision was not a penalty.
7	*Adare Finance DAC v Yellowstone Capital Management SA & Anor* [2020] EWHC 2760 (Comm)	The provision was not a penalty.
8	*Banco San Juan Internacional Inc v Petroleos De Venezuela SA* [2020] EWHC 2937 (Comm)	The provision was not a penalty.
9	*Biosol Renewables UK Ltd v Lovering & Anor (t/a R & A Properties (A Partnership)) [2021] EWHC 71* (Comm)	The provision was not a penalty
10	*De Havilland Aircraft of Canada Ltd v Spicejet Ltd* [2021] EWHC 362 (Comm)	The provision was not a penalty
11	*Bedford Investments Ltd v Sellman* [2021] EWHC 799	Application for summary judgment

	(Comm)	denied in part because Defendant had an arguable case that a provision was a penalty.
12	*ICTSI Middle East DMCC v The Government of the Republic of Sudan* [2021] EWHC 1391 (Comm)	Application for summary judgment denied in part because Defendant had an arguable case that a provision was a penalty.
13	*Eco World - Ballymore Embassy Gardens Company Ltd v Dobler UK Ltd* [2021] EWHC 2207 (TCC)	The provision was not a penalty
14	*Heritage Travel and Tourism Ltd & Anor v Windhorst & Ors* [2021] EWHC 2380 (Comm)	Unnecessary to decide whether the provision was a penalty. Had it been necessary to do so the proper course would have been to explore that question at trial.
15	*Blue-Sky Solutions Ltd v Be Caring Ltd* [2021] EWHC 2619 (Comm)	The provision in question was not incorporated into the contract, making it unnecessary to decide whether it was a penalty.
16	*Mansion Place Ltd v Fox Industrial Services Ltd* [2021] EWHC 2972 (TCC)	The provision was not a penalty.
17	*The Football Association Premier League Ltd v PPLive Sports International Ltd* [2022] EWHC 38 (Comm)	The provision was not a penalty.
18	*OCM Maritime Nile LLC & Anor v Courage Shipping Co Ltd & Or* [2022] EWHC 452 (Comm)	The provision was not a penalty.

Charterparty cases

On the question of whether an agreed damages clause which is unenforceable as a penalty still serves to cap the innocent party's recovery, there is a line of authority in cases concerning charterparties that where a clause is a penalty, the innocent party may ignore it, and claim its true loss. The cases concern a clause in the following form:

> *"Penalty for non-performance of this agreement proved damages not exceeding the estimated amount of freight."*

It is puzzling why this is said to constitute a penalty – it does not provide for the payment of an agreed sum on breach. Rather, it provides for the payment of "*proved damages*" – i.e. the real amount of loss, but subject to a cap equal to the amount of the freight. Nonetheless in *Wall* v *Rederiakt Luggude*, [1915] 3 KB 66 this clause was held to be a penalty, so fell to be ignored entirely, and did not impose any cap. Bailhache J said at p.73:

> *"You cannot under it recover more than the proved damages, and if proved damages exceed the penal sum you are restricted to the lower amount. As a penalty clause may be disregarded it is always disregarded and has become a dead letter, or from another point of view, a "brutum fulmen", as Blackburn J called it in Godard v Gray LR 6 QB at p 148."*

In *Watts, Watts & Co, Ltd* v *Mitsui & Co Ltd* [1917] AC 227 the House of Lords considered a similar clause, and held it to be a penalty, with the same result. Per Lord Sumner:

> "*I have no doubt that cl 13 is a penalty clause and immaterial in the present case. To read it otherwise is to ignore the first word "penalty". True the use of that word is not decisive; but it is not impossible to read the residue of the clause as defining a mode of calculating a mere penal sum, and to read it as a limitation of the right to recover proved damages seems to me to produce an absurd result in business. Whatever the value of the cargo or the extent of the injury to it, the shipowner's liability in respect of it would be limited to the estimated amount of the freight, however that estimate is to be made. If the cargo owner is uninsured, he stands to lose large sums for the ship's default. If he is insured he upsets the ordinary course of insurance business by depriving his underwriter of a valuable right of recourse and must suffer for this in one way or another. Nothing could be less like a "genuine covenanted pro-estimate of damage": Dunlop Pneumatic Tyre Co v New Garage and Motor Co (10) [1915] AC at p 86, per LORD DUNEDIN. The whole matter has been fully and, if I may say so, admirably discussed by BAILHACHE, J, in the recent case of Wall v Rederiaktiebolaget Luggude (2). Your Lordships decided the point in Stroms Bruks Aktie Bolag v Hutchison (8) upon a somewhat similar clause, and I think that the present case cannot really be distinguished. My only difficulty is to understand why such a provision should be inserted at all.*"

Per Lord Finlay LC:

> "*If this clause had appeared for the first time, I think it might have been construed as imposing a limitation on the damages to be recovered, but the penalty clause is an old one with a settled meaning, and the intention, if it existed, to make so fundamental a change in its effect as is suggested ought to have been much more clearly shown in order to bind the other party to the contract.*"

To the modern eye, these decisions certainly appear odd, because the result, driven by some kind of arcane trade usage, seems to be the precise opposite of the plain and ordinary meaning of the words.

Cellulose Acetate Silk

In the House of Lords case *Cellulose Acetate Silk Co Ltd* v *Widnes Foundry* (1925) Ltd [1933] AC 20, Lord Atkin expressly left open the question of whether a penalty serves as a cap on the damages which may be recovered:

> "*I desire to leave open the question whether, where a penalty is plainly less in amount than the prospective damages, there is any legal objection to suing on it, or in a suitable case ignoring it and suing for damages.*"

Robophone

In *Robophone Facilities Limited* v *Blank* [1966] 1 WLR 1428, Diplock LJ noted the problem, but did not answer it:

> "*Where the court refuses to enforce a "penalty clause" of this nature, the injured party is relegated to his right to claim that lesser measure of damages to which he would have been entitled at common law for the breach actually committed if there had been no penalty clause in the contract.*
>
> *I make no attempt, where so many others have failed, to rationalise this common law rule. It seems to be sui generis. The court has no general jurisdiction to re-form terms of a contract because it thinks them unduly onerous on one of the parties - otherwise we should not be so hard put to find tortuous constructions for exemption clauses, which are penalty clauses in reverse: we could simply refuse to enforce them. Again, it is by no means clear that "penalty clauses" are simply void, like covenants in unreasonable restraint of trade. There are dicta either way, and in Cellulose Acetate Silk v. Widnes Foundry Lord Atkins expressedly 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.*"

Steria

Steria Ltd v *Sigma Wireless Communications Ltd [2007] EWHC 3454 (TCC)*is a first instance case which predates *Cavendish* and considered (briefly and *obiter*) whether an unenforceable agreed damages provision would still serve to impose a cap on common law damages.

Sigma was contracted to supply a "*computer aided mobility mobilization and communications system*" for the fire and ambulance services operating in the eastern counties of the Republic of Ireland for a contract price of c.€6.5 million. Sigma subcontracted a substantial element of the work, namely the supply of a computer aided dispatch system, to Steria, with a sub-contract value of c.€3.1 million.

The main contract provided for Sigma to pay the employer agreed damages if it should fail to complete all the works by a certain date equal to 1% of the contract value for each week or part week of delay, subject to a maximum of 10% of the contract price. The works had apparently been completed in time, and so the employer had not levied these damages.

The sub-contract, by contrast, identified four separate tasks, and required Steria to complete each task by a certain date, and to pay damages equal to 0.25% of the subcontract price for each week that each task was delayed, with the maximum liability for late completion of each task capped at 2.5% of the subcontract price. Steria argued that this was a penalty because, so long as all four tasks were completed by the date for completion of the fourth task, Sigma would not be liable to pay any damages under the main contract, even if the first three tasks had been completed late.

HHJ Davies rejected this argument, holding the clause in the subcontract not to be a penalty because there was no *substantial* discrepancy between the agreed damages and damages likely to be suffered by Sigma. It was quite possible for delays in completing the four tasks to result in an overall delay exposing Sigma to liability for agreed damages under the main contract. It was also possible that delay by Steria in tasks 1-3 might disrupt or delay Sigma and/or its other sub-contractors in their respective works, thereby leading to Sigma incurring loss and expense which it was unable to recover under the main contract, and exposing it to delay and disruption claims from other sub-contractors which it could not pass on the employer.

HHJ Davies also rejected Steria's argument that the agreed damages clause was void for uncertainty. On the question of whether the agreed damages would have served to cap Sigma's liability for common law damages:

> "*Having upheld the liquidated damages provisions of clause 7.1 and Schedule 6, it is unnecessary for me to consider the further argument as to whether the cap in those provisions would also apply to cap the alternative claim for general damages. It is clear in my judgment from the concluding words of clause 7.1 that the entitlement to liquidated damages is Sigma's sole remedy for delay by Steria, so that it is not possible for Sigma to advance its claims for general damages as an alternative. 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.*"

The words in question were: "*Such deduction or payment shall be in full satisfaction of and to the exclusion of any other remedy of the Contractor against the Sub-Contractor in respect of the Sub-Contractor's failure to complete within the time for completion of the Sub-Contract Works*".

Cavendish

The question of whether a penalty serves as a cap on common law damages was not addressed directly in *Cavendish*. Lords Neuberger and Sumption (with whom Lord Carnwarth agreed) did however reject a suggestion by the Court of Appeal in *Jobson* v *Johnson* [1989] 1 WLR 1026 that a penalty provision could be partially enforced, i.e. only to the extent of any actual loss suffered by the breach:

> "*[9] the penalty clause is wholly unenforceable … Deprived of the benefit of the provision, the innocent party is left to his remedy in damages under the general law. …*
>
> *[87] If, as the authorities show, the penal consequences of a contractual provision fall to be determined as at the time of the agreement, and a provision found to be a penalty is unenforceable, it is impossible to see how it can be enforceable on terms.*"

Lord Hodge agreed at [283]:

> "*In English law a penalty clause cannot be enforced. For the reasons given by Lord Neuberger and Lord Sumption in their judgment (at paras 84-87) I think that the decision of the Court of Appeal in Jobson v Johnston was incorrect in so far as it modified a penalty clause and should be overruled.*"

If a penalty were held to operate as a cap, then it would not be "*wholly unenforceable*".

Eco World

Eco World - Ballymore Embassy Gardens Company Ltd v *Dobler UK Ltd* [2021] EWHC 2207 (TCC) covers two questions of importance concerning agreed damages in construction contracts. The first concerns sectional completion and the second, which is the more salient for this article, concerns whether a penalty clause caps recovery at common law.

Sectional completion in *Eco World*

Some construction projects are inherently divisible in the sense that individual parts are valuable to the employer as soon as they are completed even while other parts remain incomplete. The most obvious examples are the individual houses within a housing development and individual floors in an office block. For such a project, the contract will often provide for parts of the project to be handed over to the employer as soon as they are completed, or else give the employer an option to take early possession of them. Such developments can be contrasted with (single-train) power, process and manufacturing projects, where each individual part of the system is only useful if all the other parts have been finished.

In *Dunlop* Lord Dunedin had observed that: "*There is a presumption (but no more) that it is 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*".

This gave rise to the idea that, where a construction contract provided for partial possession, any agreed damages clause must contain a mechanism to reduce the level of liquidated damages which will be payable for late completion to give credit for any part of the development which the employer has taken possession of prior to completion, and that if the agreed damages clause did not make such provision then it was automatically void as a penalty. The result is that, rather than providing a single, headline rate of liquidated damages construction contracts often seek to make provision for damages to be reduced where an employer takes early possession. With such clauses comes an increase in complexity, and an increased risk of errors in drafting. In an attempt to ensure that the agreed damages are not a penalty, they become so complicated and to be inoperable.

In the *Eco World* case EWB retained Dobler to design, supply and install façades and glazing for an apartment complex comprising three blocks. The contract provided for Dobler to pay liquidated damages at a certain rate if it failed achieve practical completion of the works to all three blocks by a certain date. Block A comprised high value apartments, and Blocks B and C comprised affordable housing. There was provision which entitled EWB to take over part of the Works prior to practical completion of the whole. The contract did not provide any mechanism for adjustment to be made to the rate of liquidated damages payable thereafter.

EWB applied to the court seeking a declaration that the agreed damages were a penalty, and so void or unenforceable. The case thus supplies an example of an employer attacking an agreed damages clause. EWB submitted that where an employer under a construction contract has (and exercises) a contractual right to take early possession, but the liquidated damages provisions do not contain a mechanism for reducing the level of liquidated damages to reflect such early possession, the liquidated damages provisions are void and/or unenforceable. Reliance for that proposition was placed on the following extracts from the leading construction law textbooks. Keating on Construction Contracts (11th Edition) (2021) at paragraph 10-023 states:

> *"Difficulties can arise where a single sum is stipulated for liquidated damages but the works are to be completed in sections at different times or where the employer takes possession of part of the works before completion of the whole. Unless there are effective provisions for dividing the single sum between the sections or reducing it in proportion to the part taken into possession, a claim for liquidated damages will fail."*

Hudson's Building and Engineering Contracts (14th Edition) (2020) at paragraph 6-024 states:

> *"… in the absence of a properly completed contractual mechanism for sectional completion and accompanying liquidated damages, it has been held the liquidated damages clauses are liable to be rendered inoperable or invalidated through the Employer taking possession of a section of the works. Unless there are effective provisions for dividing the single sum between the sections or reducing it in proportion to the part taken into possession, a claim for liquidated damages will fail."*

O'Farrell J said of this at [68]:

> "*It is important not to elevate statements of general principle into an inflexible rule of law. The above extracts do not state that liquidated damages provisions will never be enforceable where sectional completion or partial possession is used without any related reduction in the liquidated damages payable; they identify the potential danger of failing to draft effective provisions to respond in such circumstances. In each case, it is necessary to construe the relevant provisions of the contract in question, adopting the established rules of contractual interpretation, to determine whether they give rise to a liquidated damages regime that is certain and enforceable.*"

The cases which EWB relied upon were *Bramall & Ogden* v *Sheffield City Council* (1983) 29 BLR 73 and *Taylor Woodrow Holdings Limited* v *Barnes & Elliott Limited* [2004] EWHC 3319 (TCC). The judge identified that, in each case, the liquidated damages clause had been held to be unenforceable not because it was a penalty but because it was inoperable.

Bramall had concerned a development comprising 123 dwellings and associated works Clause 22 provided for payment of "*a sum calculated at the rate stated in the Appendix as Liquidated and Ascertained Damages*" in respect of any failure to complete the works by the contractual date for completion. The rate for liquidated damages in the Appendix was expressed as "*at the rate of £20 per week for each uncompleted dwelling*". There was no contractual provision for sectional completion but as individual houses were completed they were taken over by the employer by consent. Clause 16(e) of the contract provided:

> *"In lieu of any sum to be paid or allowed by the Contractor under clause 22 of these Conditions in respect of any period during which the works may remain incomplete occurring after the date on which the Employer shall have taken possession of the relevant part there shall be paid or allowed such sum as bears the same ratio to the sum which would be paid or allowed apart from the provisions of this Condition as does the Contract Sum less the total value of the relevant part to the Contract Sum."*

The intention was that where parts of the works were taken into possession by consent, the sum to be paid or allowed as liquidated damages should be proportionately reduced on the basis of the value of the occupied part relative to the full contract sum. The court found that the provision was inoperable by reason of the inconsistency between clause 16(e) and the Appendix; the calculation required in clause 16(e) could not be carried out by reference to a rate per uncompleted dwelling, rather than a specific rate for the whole of the works, particularly in circumstances where the works were not confined to the construction of the dwellings.

In *Taylor* the contract provided for sectional completion and a *pro-rata* adjustment of liquidated damages to take account of partial possession, but the adjustment could not be calculated because the scope of works falling within each section was not adequately defined or capable of being ascertained from the contract documents.

O'Farrell J observed:

> " *… thus, in the cases above, the courts did not reject, as automatically fatal, the concept of one rate of liquidated damages for late completion of the works where there is sectional completion or partial possession; rather, the express provisions in each case simply did not work because of errors in drafting".*
>
> *As a matter of construction, the provisions in this case are reasonably clear and certain. There is one completion date for the whole of the Works. Liquidated damages are payable at the rate set out in the Trade Contract Particulars for failure to complete the whole of the Works by the completion date. There is no reduction in the rate of liquidated damages where partial completion is achieved or the employer takes over part of the Works prior to practical completion. Such provisions are capable of being operated. The Contract in this case does not give rise to the difficulties found in Brammell v Ogden or Barnes & Elliott that rendered the provisions void and unenforceable.*
>
> *The issue that then arises is whether the liquidated damages provision, as construed above, is penal …*"

The judge noted Lord Dunedin's presumption that a provision would be penal if 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. She went on to hold, however, applying the test in *Cavendish*, that the provision in question was not extravagant or unconscionable, giving four reasons:

(a) The clause was negotiated by the parties, who had the benefit of external legal advice (presumably meaning that the threshold for the clause to be considered unconscionable and extravagant was higher than if this had been otherwise).

(b) EWB had a legitimate interest in enforcing the primary obligation of Dobler to complete the Works as a whole by the New Completion Date. Late completion of any part of the Works was likely to have an adverse impact on the work of following trade contractors carrying out fit out and other finishing works, causing not just delay but also disruption to the project as a whole. Late completion of Blocks B and/or C would expose EWB to liability for liquidated damages to the local authority. Late completion of Block A would expose EWB to the risk of losing purchasers for the apartments.

(c) Quantification of the damages that would be suffered by EWB would be difficult, particularly if part, but not all, of the Works were completed on time. Different combinations of partially incomplete blocks could result in a wide range of the categories of loss referred to above. By fixing in advance the liquidated damages payable for late completion of the whole Works, the parties avoided the difficulty of calculating and proving such loss.

(d) The level of damages was set at £25,000 per week (or pro rata for part of a week), with a grace period of four weeks and a maximum of 7% of the Trade Contract Sum, a cap of £602,336.63 at the date of the Contract. There was no evidence, and it was not suggested by either party, that such level of damages was unreasonable or disproportionate to the likely losses in the event of late completion of the work in any one or more of the blocks.

Capping effect in *Eco World*

Having decided that the agreed damages clause was not a penalty, O'Farrell J nonetheless went on to consider whether, if the agreed damages clause had been unenforceable, it would still have served as a cap on recovery at common law.

The clause in question said:

"*2.32.1 If the Trade Contractor fails to complete the Works or works in a Section by the relevant Date for Completion of a Section or the Works, the Employer may, not later than 5 days before the final date for payment of the amount payable under clause 4.16, give notice to the Trade Contractor which shall state that for the period between the relevant Date for Completion of a Section or the Works and the date of practical completion of the Works or Section that:*

2.32.1.1 he requires the Trade Contractor to pay liquidated damages at the rate stated in the Trade Contract Particulars, or lesser rate stated in the notice, in which event the Employer may recover the same as a debt; and/or

2.32.1.2 that he will withhold or deduct liquidated damages at the rate stated in the Trade Contract Particulars, or at such lesser stated rate, from sums due to the Trade Contractor."

The Trade Contract Particulars specified the rate of liquidated damages applicable under the Contract:

> "*The following rates of liquidated damages will apply for the first 4 weeks (inclusive) of delay in completion of the Works beyond the Date for Completion:*
>
> • *£nil per week or pro rata for part of a week.*
>
> *Liquidated damages will apply thereafter at the rate of £25,000 per week (or pro rata for part of a week) up to an aggregate maximum of 7% of the final Trade Contract Sum…*"

O'Farrell J reviewed the authorities on whether penalty clauses operate as a cap (though *Steria* was not cited). She concluded at [116]:

> "*Each clause must be construed in accordance with the established principles of contractual interpretation summarised above. In my judgment, clause 2.32.1 and the Trade Contract Particulars would operate as a limitation of liability provision, even if the liquidated damages were void or a penalty. Having regard to their Lordships' opinions in Cavendish Square, the agreed damages of £25,000 per week would fall away as unenforceable but the court would strive to give effect to the separate part of the provision containing an express limitation on liability at 7% of the final Trade Contract Sum. A literal reading of the provision suggests that the 7% cap would apply only to the liquidated damages and not to any general damages. However, the objective understanding of the parties in the commercial context of the Contract would be that the provision served two purposes: first, to provide for, and quantify, automatic liability for damages in the event of delay; second, to limit Dobler's overall liability for late completion to a specific percentage of the final contract sum. The clear intention of the parties was that Dobler's liability for delay damages would be so limited."*

Whether a penalty clause serves to limit recovery at common law, then, is a question of construction. One can, however, see that the construction adopted by the judge is not, perhaps, the most natural reading. The clause says, "*Liquidated damages will apply … up to an aggregate maximum of 7% of the final Trade Contract Sum*". What is being limited is the amount of liquidated damages. Nonetheless, the clause is construed to treat this as expressing an intention that the contractor's liability (whether that is for liquidated damages or common law damages) be limited to that amount.

Buckingham

Buckingham Group Contracting Ltd v *Peel L&P Investments and Property Ltd* [2022] EWHC 1842 (TCC) is a decision of Alexander Nissen QC sitting as a Deputy High Court Judge. In that case, the employer retained the contractor to construct a plant for manufacturing corrugated cardboard. The contract provided for a complex system of agreed damages, with different rates applying if different parts of the works were not completed by certain milestone dates and damages to be refunded if the contractor used reasonable efforts to accelerate the works to recover delays in order to achieve the start of production by certain date. It is unclear what the logic behind this was. So far as one can tell, the only thing that would cause the employer loss would be a delay to the stat of production. Whether the office floor slabs were completed by any particular date was by-the-by.

The contractor sought to argue that the agreed damages provisions were contradictory and inoperable, but the court held that they were sufficiently certain and enforceable. That made it unnecessary to consider whether, if the agreed damages were unenforceable, they served to cap the damages which the employer could recover at common law. Schedule 10 set out the agreed damages, and included the words:

"*Cap on Maximum LADs* [Liquidated and Ascertained Damages] *7.5% £1,928,253.77*"

The judge cited *Eco World*, agreeing that *Cavendish* provides persuasive support for the view that if a liquidated damages provision is void it is wholly unenforceable and that the question which next arises is whether, on a proper construction of the clause in question, it also operates as a parallel general limitation of liability provision which could be enforced even if the liquidated damages were void or penal.

The Judge reached a different conclusion, however, to that in *Eco World*, saying:

> "*9. limited benefit is to be gained from seeing how a different clause in a different contract was interpreted. At best, Eco World demonstrates that it is possible in principle for a clause to operate as a general limitation of liability provision even though it is literally expressed as applicable only to liquidated damages.*
>
> *97. Notably in the present case, there is no contention that the weekly limit of £200,000 operates as a limit on liability in respect of general damages. The focus is entirely on the expression: "Cap on Maximum LADs 7.5% £1,928,253.77.*
>
> *98. In my judgment, the language of the provision is quite clear. As was emphasised in Arnold v Britton at [17] the meaning is most obviously gleaned from the language used. The cap is "on Maximum LADs", not on anything other than LADs. There is nothing within clause 2.29A (the key provision which triggers the application of Schedule 10) which suggests that any alternative liability for any general damages would be capped. … the cap sits within a Schedule exclusively concerned with Milestone Dates and individual rates for liquidated damages applicable thereto. Both are the product of clause 2.29A and, in line with [Cavendish], should stand or fall together. No part of Schedule 10 is concerned with liability for general damages. Both the individual rates for liquidated damages and the cap are expressed as percentages of the Contract Sum and, to that extent, form part of a single scheme. Given the clarity of the words used by the parties in this case, I see no basis for concluding that the clause should serve the additional function of operating as a cap on Buckingham's overall liability for delay arising from breach of that or some other provision.*"

Conclusion

The question of whether a clause which is unenforceable as a penalty survives to cap liability has not been conclusively resolved.

Steria, Eco World and *Buckingham* are all *obiter*, in the sense that in each case the agreed damages clause was held to be enforceable, and so the question of whether it would have served as a cap was not strictly required to be decided. That said, the principle applied in all three cases seems likely to be correct. There is no rule of law that if an agreed damages clauses is unenforceable as a penalty then damages are either capped, or not capped, in the same amount. Whether the agreed damages clause has that effect is a matter of construction – whether the clause in question also operates as a parallel general limitation of liability provision.

Where the cases diverge is in their construction of the relevant clauses. In *Steria*, the judge's view seems to be that because the agreed damages amounts stated to be: "*… in full satisfaction of and to the exclusion of any other remedy …"* that means the agreed damages are a self-contained regime, quite separate from the remedy of common law damages. In *Eco World*, the contract said in terms that "*Liquidated damages will apply … up to an aggregate maximum of 7% of the final Trade Contract Sum*", but the court construed "*Liquidated damages*" to mean not just liquidated damages but also common law damages. In *Buckingham*, by contrast, the contract said, "*Cap on Maximum LADs 7.5%*", and the court construed "*LADs*" to mean just LADs (liquidated damages).

The underlying problem in all these cases is, ultimately, the penalty rule. When contractors and employers negotiate contracts and set the level of agreed damages they undoubtedly do so on the assumption, and in the expectation, that what they have agreed will be enforced, so that the agreed damages represent the upper limit on their liability. If one had asked the parties at the outset how much the contractor's maximum liability for delay was, they would have given you a figure equal to the agreed damages – that, at the end of the day, is the maximum amount that is expected, and intended, to be paid. It is only because the aberrant penalty rule interferes, and prevents what the parties have agreed in that regard from being enforced, that it becomes necessary to ask the artificial question of whether they have agreed that any common law damages will be capped at the same level, starting from the presumption that contracting parties have used words with the intention that they be given their conventional meaning – that Liquidated Damages means just that, namely Liquidated Damages. The whole exercise starts with a contradiction: refusing to enforce what the parties have agreed but then purporting to ask what they have agreed.

Whether the unenforceable penalty clause will serve to cap common law damages turns on the attitude of the judge or arbitrator on the day and, in particular, how strongly inclined they are to presume that words mean what they say. The authorities do point to treating that presumption as a strong one in the case of substantial construction contracts, which are typically based on sophisticated standard forms pored over by professional advisers. In *Wood* v *Capita Insurance Services* [2017[UKSC 24 Lord Hodge (with whom all their Lordships agreed) recognised that:

> *"Some agreements may be successfully interpreted principally by textual analysis, for example because of their sophistication and complexity and because they have been negotiated and prepared with the assistance of skilled professionals. The correct interpretation of other contracts may be achieved by a greater emphasis on the factual matrix, for example because of their informality, brevity or the absence of skilled professional assistance."*

Construction contracts undoubtedly, then, will tend to fall towards the "*textual*" end of the scale. The truth will often turn out to be that the text does not say anything at all about common law damages, because it was written entirely on the assumption that the agreed damages would be payable. The more clear, careful and categorical the parties have been to record their agreement as to what agreed damages will be payable, the less likely it will be that that there is any phrase which could be interpreted as referring also to common law damages. So, ironically, once the agreed damages have been held to be a penalty, the more one treats the parties' words as sacred and purposeful the more divergent the end result becomes from what was probably the parties' stating intention or expectation.

It is tempting to say that none of this matters - agreed damages clauses are so rarely struck down as penalties that the issue is academic, just as it was in *Steria*, *Eco World* and *Buckingham*. Yet, undoubtedly, there will eventually come a case in which it matters, where an agreed damages clause is struck down as a penalty and the question of whether it survives to limit common law damages stands to make a huge difference to the contractor's liability. The prudent thing (from the contractor's perspective) is to deal with the matter up-front in the contract, and always to record expressly that, if the agreed damages provision is void or unenforceable, then the contractor's liability shall not in any event exceed a stated amount.