

# *Liquidated and unliquidated damages*



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# Liquidated and unliquidated damages

## Introduction

Liquidated damages clauses are used in many types of contracts, most frequently in IT and construction contracts.

A liquidated damages clause (or an agreed damages clause), is a provision in a contract that fixes the sum payable as damages for a party's breach. In comparison, unliquidated damages are damages for a party's breach which have not been pre-estimated.

The Principal function of a liquidated damages clause is to quantify the damages payable in the event of breach of the contract. The clause will only be relevant once liability is proven or admitted.

In an action for breach of contract, to recover damages beyond nominal damages, damage must either be proven or admitted. The advantage of a liquidated damages clause is that there is no need to prove the actual loss, because the clause stipulates a pre-assessment or pre-estimation of damages.<sup>1</sup>

Some of the advantages of including a liquidated damages clause in a contract are that it:

- provides certainty to the parties
- facilitates the recovery of damages by avoiding the requirement of proof of loss
- simplifies the dispute resolution procedure
- may induce performance of the contract.

Liquidated damages clauses regulate the rights of parties after a contract is breached, or alternatively quantify the party's secondary obligation to pay damages (which survives termination).<sup>2</sup> The use of 'nil' or 'n/a' for the rate of liquidated damages

Standard form construction contracts often require the insertion of a rate for liquidated damages. Parties sometimes insert 'NIL' or 'N/A' for this rate.<sup>3</sup>

The effect of inserting 'NIL' or similar words in liquidated damages clauses has been the subject of differing opinions.<sup>4</sup>

## Australian law

In the Australian case of *J-Corp Pty Ltd v Mladenis*<sup>5</sup> (J-Corp), the appellant builder entered into a lump sum building contract with the respondent Owners, under which the builder agreed to construct a house on the

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<sup>1</sup> See *Boucaut Bay Co Ltd v Commonwealth* (1927) 40 CLR 98.

<sup>2</sup> *Robophone Facilities Ltd v Blank* [1966] 3 All ER 128.

<sup>3</sup> *Silent Vector Pty Ltd t/as Sizer Builders v Squarcini* [2008] WASC 246, [98].

<sup>4</sup> *J-Corp Pty Ltd v Mladenis (J-Corp)* (2010) 26 BCL 106, [61].

<sup>5</sup> (2010) 26 BCL 106.

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Owners' land for the sum of \$311,484.12.<sup>6</sup> The contract was prepared by the builder and was a standard form of contract used by the builder.<sup>7</sup>

The liquidated damages clause of the contract provided that if the builder failed to complete works within specified time, the builder was liable to pay liquidated damages at rate of 'NIL DOLLARS (\$00.00)' per day for each day beyond the due date for practical completion, as follows:

*If the Builder breaches sub-clause 11.1, it shall be liable to pay the Proprietor liquidated damages at the rate of NIL DOLLARS (\$00.00) per day for each day beyond the due date for practical completion until practical completion is deemed to have taken place.*

The builder breached the contract failing to complete the works by the due date.<sup>8</sup> The court had to decide whether the liquidated damages clause excluded the right to common law (unliquidated) damages for losses suffered by the Owner due to the builder's breach.

The court held that the use of 'NIL' did not exclude the Owner's right to claim unliquidated damages.<sup>9</sup> The court took the following considerations into account:

- the common intention of the parties, by reference to what a reasonable person would understand the contract to mean<sup>10</sup>
- where parties enter building contracts, this purpose may include allocating risk for loss or damage<sup>11</sup>
- 'NIL' can be used to limit the extent in damages of a party's liability<sup>12</sup>
- the amount for liquidated damages here was not so excessive as to constitute a penalty<sup>13</sup>
- there is a reason for keeping liquidated and unliquidated damages clauses separate, rather than assuming that 'NIL' applies to both. Liquidated damages provisions relieve the Owner of proving actual damage, so in the absence of a liquidated damages clause the Owner may only have the potentially costly and time-consuming remedy of unliquidated damages<sup>14</sup>

The court emphasised that 'clear words' are required to rebut the presumption that a contracting party does not intend to abandon a common law breach of contract remedy.<sup>15</sup> The clause here did not contain clear words to express the intention that the Owner could not claim unliquidated damages; it only provided that no liquidated damages could be claimed.<sup>16</sup> This case followed the reasoning of *Silent Vector Pty Ltd T/as Sizer Builders v Squarcini*.<sup>17</sup>

Like in *J-Corp*, the issue was whether a liquidated damages clause in a contract operated to exclude unliquidated damages. In *Silent Vector* 'N/A' was inserted as the rate for 'liquidated damages per day'. Like in *J-*

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<sup>6</sup> (2010) 26 BCL 106, [13].

<sup>7</sup> Ibid.

<sup>8</sup> Ibid, [21].

<sup>9</sup> Ibid, [60].

<sup>10</sup> Ibid, [33].

<sup>11</sup> Ibid, [6].

<sup>12</sup> Ibid, [36].

<sup>13</sup> Ibid, [35].

<sup>14</sup> Ibid, [48-49].

<sup>15</sup> *Gilbert-Ash (Northern) Ltd v Modern Engineering (Bristol) Ltd* [1974] AC 689, 717-718; see also *Concut Pty Ltd v Worrell* (2000) 176 ALR 693; *Waterways Authority of New South Wales v Coal And Allied (Operations) Pty Ltd* [2007] NSWCA 276, [44].

<sup>16</sup> *J-Corp Pty Ltd v Mladenis (J-Corp)* (2010) 26 BCL 106, [47].

<sup>17</sup> *Silent Vector Pty Ltd t/as Sizer Builders v Squarcini* [2008] WASC 246.

Corp, the court decided that the Principal could claim unliquidated damages for delay, because 'N/A' indicated the parties intention that only the entire liquidated damages clause would not apply.

The recent cases of *Andrews v Australia and New Zealand Banking Group Ltd*<sup>18</sup> and *Re Pioneer Energy Holdings Pty Ltd*<sup>19</sup> significantly expanded the penalty doctrine in Australia, together holding that:

- equity may hold that a provision is a penalty even if it is not triggered by a breach of contract
- provisions requiring compensation to be provided by one party to another should be proportionate to the potential loss suffered
- express agreement between parties that compensation is reasonable will not necessarily oust the doctrine of penalties
- provisions that incentivise parties to meet deadlines and carry out their obligations, as opposed to compensating a party where another party does not fulfil stipulated obligations, are more likely to be enforceable as such provisions may avoid the issue of penalties altogether.

## **English law**

In the leading English case of *Temloc Ltd v Errill Properties Ltd*,<sup>20</sup> unliquidated damages were excluded by the use of '£ Nil' as the rate of liquidated damages.

The contract outlined the following regarding damages for non-completion:

### *Damages for non-completion*

*If the Contractor fails to complete the Works by the Completion Date then the Architect shall issue a certificate to that effect.*

*Subject to the issue of a certificate ...the Contractor shall ...pay or allow to the Employer the whole or such part as may be specified in writing by the Employer of a sum calculated at the rate stated in the Appendix as liquidated and ascertained ...*<sup>21</sup>

The court decided that the liquidated damages clause was an exhaustive agreement for the treatment of damages. As the parties agreed that damages for late completion were to be liquidated damages, it could not have been intended that the Principal should also be allowed unliquidated damages.<sup>22</sup>

## **Drafting liquidated damages clauses**

The presumption is that parties in building contracts are entitled to all remedies for breach as would arise by operation of law.

There is no general rule about the use of 'NIL' in a liquidated damages clause. The effect of 'NIL' will depend on the proper construction of the contract as a whole.

In Australia the courts have recommended that parties should be careful to delete, amend or add clauses to such contracts in a consistent and clear manner.<sup>23</sup>

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18 (2012) 247 CLR 205.

19 [2013] NSWSC 1134.

20 (1987) 39 BLR 30.

21 Ibid, 34.

22 Ibid, 39.

23 *Silent Vector Pty Ltd t/as Sizer Builders v Squarcini* [2008] WASC 246, [99].

## Liquidated and unliquidated damages

Parties who wish to exclude liability for unliquidated damages need to state this clearly and unequivocally in the contract. Parties should include a clear statement that the liquidated damages provided for under the contract are the sole remedy available for delays in completion of the works and the parties agree that general damages are not available to the Principal in the event of delay by the Contractor for such delay.

### ***Further reading***

- Michael Hollingdale, 'Designing and enforcing liquidated damages clauses to maximise recovery' (2005) 21 *Building and Construction Law* 412.
- Trevor Thomas, '\$Nil liquidated damages: An exhaustive remedy for delay under a construction contract' (2008) 24 *Building and Construction Law* 82.

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