CONSTRUCTION FOCUS

Construction focus: Delay damages and termination – order is restored

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Delay is ubiquitous in construction, and termination – while not ubiquitous – is not an uncommon occurrence. Yet a shadow of uncertainty has loomed over the relationship between delay damages and termination for more than two years, since the Court of Appeal gave its unorthodox ruling in *Triple Point Technology, Inc v PTT Public Company Ltd* [2019] in March 2019. However, in the final chapter of a lengthy and oscillating legal battle between Triple Point Technology Inc and PTT Public Company Ltd, the United Kingdom Supreme Court handed down a judgment last month that has restored order and provided a welcome helping of certainty.

Here, we track the highs and lows of that dispute and discuss the Supreme Court's answer to the above question, as well as the court's useful comments on clauses that cap liability.

However, we propose to start with a recap on the basic principles of delay damages.

Damages for delay

Simply put, when a contractor fails to achieve practical completion of a project by the contractually agreed completion date then, absent any circumstances that permit an extension of time, the contractor will be in breach of the building contract. The employer's remedy will be damages in respect of the losses caused by that breach.

General damages

The basic principle is that the measure of those damages, known as general damages, will

be the sum required to put the innocent party (ie the employer) in the same situation it would have been had the contract been performed, so far as money can do so and subject to the innocent party being able to demonstrate that:

- it has taken steps to mitigate its losses;
- the damages sought are reasonable and proportionate to the breach; and
- the losses claimed are not too remote a consequence of the breach.

As a result, it can require a great deal of time and effort for an employer to establish a claim for general damages and the exercise provides a plethora of points for employers and contractors (and their lawyers) to squabble over. Hence Lord Leggat's accurate summation in *Triple Point* that doing so 'would often be an intractable task capable of giving rise to costly disputes'.

Liquidated damages

One of the great strengths of English law is the freedom accorded to the parties to agree the terms on which they enter contract. That has allowed parties to seek to circumvent the, often painful, process of establishing and debating general damages by agreeing that predetermined liquidated damages shall be payable in the event of a specified breach. Liquidated damages are, of course, a common feature of construction contracts.

The sum payable under a liquidated damages clause should be a genuine pre-estimate, made at the time of contract formation, of the losses that will result from the breach to which the liquidated damages attach (ie a pre-estimate of the losses that will arise from a culpable delay to practical completion the works).

Many will be familiar with the traditional principle that liquidated damages will be unenforceable if the paying party can establish that those damages constitute a penalty. However, in 2015, the case of *Cavendish Square Holding BV v Talal El Makdessi; ParkingEye Limited v Beavis* [2015] saw that principle revisited by the Supreme Court. The consequence of the Supreme Court's considerations was that while penalties remain outlawed, that does not necessarily mean that liquidated damages cannot exceed the innocent party's actual losses arising from the breach, so long as they are proportionate to the innocent party's legitimate interests in having the contract performed. As Lords Sumption and Neuberger stated:

> *… in the case of a straightforward damages clause, that interest will rarely extend beyond compensation for the breach… but compensation is not necessarily the only legitimate interest.*

As such, while in a construction contract, liquidated damages for delay are unlikely to be allowed to extend beyond the financial losses estimated to arise from that delay, provided that the detriment imposed by the liquidated damages is not out of all proportion to the legitimate interest of having the works completed on time; the liquidated damages should be enforceable, and should not be deemed penal, even if they exceed the actual loss incurred.

General vs liquidated

The certainty and convenience afforded to parties by liquidated damages clauses does not, however, come without potential drawbacks. As liquidated damages require an estimate of loss to be made months, or even years, before those damages might become payable, the liquidated damages may transpire to be less, or more, than the actual losses caused by the attendant breach. As liquidated damages are an exclusive remedy, in the event that they are less than the actual losses suffered, the employer will have to make do and will not be able to 'top up' its liquidated damages with a claim for general damages. But if the liquidated damages exceed the employer's losses, they will be beyond dispute for the contractor, who will be bound to pay them (unless it can establish they are penal).

Nevertheless, those drawbacks are all but unanimously considered to be offset by the benefits that liquidated damages clauses can afford to both employers and contractors, by providing a predictable remedy in the event of a specified breach. Such clauses relieve the employer of having to show that it has taken steps to mitigate its losses, that the losses claimed do not offend the rules on remoteness, and that they are reasonable and proportionate. In addition, the employer can seek to protect its legitimate interest of having its project completed on time, even if significant financial loss is not necessarily a consequence of delay. On the other hand, for the contractor, a liquidated damages clause acts as a cap on its liability in the event of a delay and gives it certainty over what costs will be in the event of a delay to the works.

Article 5.3 (liquidated damages)

'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 per cent) of undelivered work per day of delay from the due date for delivery up to the date PTT accepts such work…'.

Triple Point

And so it was that when, in 2013, PTT (a Thai oil and gas trading company) entered into a $6.92m contract with Triple Point (a US company specialising in trading software) for the provision of a commodity trading and risk management system, the parties included the seemingly uncontroversial liquidated damages clause reproduced in the adjacent box. The parties also agreed that, despite their trans-Pacific relationship, the contract would be governed by English law; hence the dispute making its way through the principles of English law in the English courts (and a good example of the UK 'exporting' legal services). Though arising out of on an IT contract, the dispute bears many of the features of a construction dispute, and the rulings of each court directly impact the interpretation of construction contracts governed by English law.

Triple Point's works were significantly delayed, and as a result, the first two stages of the work were completed 149 days late. In March 2014, the parties agreed payment in respect

of the first milestone. Triple Point, however, demanded further payment for invoices that it had submitted to PTT. PTT refused payment, relying on a clause of the contract which specified that payment shall be by milestone (not invoice). Triple Point, in turn, refused to carry out further work, leading PTT to terminate the contract in March 2015 before Triple Point had completed the remaining (and delayed) stages of work.

By February 2015, matters remained unresolved, and Triple Point commenced proceedings in the Technology and Construction Court. In response, PTT counterclaimed for:

- liquidated damages in respect of its losses arising out of the delay, pursuant to Article 5.3; and
- general damages in respect of its losses arising out of termination of the contract.

It was not until November 2016, 21 months later, that the case made it to trial, with the decision handed down in August 2017.

Article 12.3

'CONTRACTOR shall be liable to PTT for any damage suffered by PTT as a consequence of CONTRACTOR'S breach of contract, including software defects or inability to perform "Fully Complies" or "Partially Complies" functionalities as illustrated in Section 24 of Part III Project Services

The total liability of CONTRACTOR to PTT under the Contract shall be limited to the Contract Price received by CONTRACTOR with respect to the services or deliverables involved under this Contract.

Except for the specific remedies expressly identified as such in this Contract, PTT's exclusive remedy for any claim arising out of this Contract will be for CONTRACTOR, upon receipt of written notice, to use best endeavour to cure the breach at its expense, or failing that to return the fees paid to CONTRATOR for the Services or Deliverables related to the breach.

This limitation of liability shall not apply to CONTRACTOR's liability resulting from fraud, negligence, gross negligence or wilful misconduct of CONTRACTOR or any of its officers, employees or agents.'

In the Technology and Construction Court

Jefford J dismissed Triple Point's claim for invoiced sums. Instead, she held that PTT was entitled to recover liquidated damages in the sum of $3.459m in respect of the period of delay up to the date of termination. Further, she assessed PTT's general damages in respect of wasted costs and costs of procuring a replacement system, which followed from the termination ('termination losses'), to be $11.204m.

However, the parties had agreed to include a clause (reproduced in the box below) limiting

Triple Point's liability for damages under the contract, which in monetary terms equated to a limit of $1.038m.

Jefford J's interpretation of Article 12.3 was that, while the cap did not apply to the liquidated damages for delay, it did apply to the damages for PTT's termination losses. Thus, PTT's total damages were slashed from c.$14.6m to c.$4.5m.

Neither party was content, with both Triple Point and PTT disagreeing with Jefford J's decisions. Triple Point appealed on the grounds that it was entitled to payment on its invoices and that liquidated damages were caught by the cap, with the majority being irrecoverable in any event. PTT cross-appealed on the ground that the cap did not apply to any of the damages it sought.

The Court of Appeal

And so, in January 2019, 16 months after Jefford J's decision was handed down, the parties found themselves in the Court of Appeal before Lord Justice Lewison, Lord Justice Floyd and Sir Rupert Jackson, the latter of whom – a former judge in charge of the Technology and Construction Court (TCC) – gave the leading judgment in March 2019.

As in the TCC, Triple Point's claim for payment on its invoices was rejected, with Sir Rupert Jackson holding that the contract, which provided for payment on milestones, came top in the order of precedence of the other contractual documents (highlighting the importance of precedence clauses in substantial construction and engineering contracts).

However, there the Court of Appeal parted ways with both the TCC and with what many had understood to be the orthodox position on liquidated damages upon termination. In his judgment, Sir Rupert Jackson identified three categories into which a liquidated damage clause might fall upon termination of the contract:

> 1. The liquidated damages fall away completely in respect of any incomplete work, and the employer must seek general damages for all losses caused by the delay.
> 2. The liquidated damages are recoverable for the period up to the date of termination, but the employer must seek general damages for any further losses caused by the delay after termination.
> 3. The liquidated damages are recoverable up to the date of completion of the works by a third party.

The Court of Appeal's interpretation of Article 5.3 (reproduced in the above boxout) was that the words 'up to the date PTT accepts such work' meant that following termination, for any liquidated damages to be recoverable, the work had to be completed by Triple Point itself and not by a replacement contractor, ie the clause fell within the first category. Thus, as Triple Point's engagement had been terminated and it had not, therefore, completed the whole of the works itself, PTT was only entitled to recover liquidated damages in respect of the works that Triple Point had completed, ie liquidated damages for the 149-day delay in completing the first two stages of phase 1. Accordingly, Jefford J's award of $3.5m in liquidated damages was set aside and instead PTT was judged to be entitled to just $154,662 in liquidated damages.

However, the Court of Appeal did not stop there. In Sir Rupert Jackson's view, the second sentence of Article 12.3 imposed a cap on Triple Point's *total* liability, such that the cap also applied to the liquidated damages. As the cap had been exhausted by PTT's other

claims, PTT could not even recover the $154,662. As such, having left the TCC with an award of c.$4.5m, following the Court of Appeal's involvement, PTT's damages had been trimmed down to a relatively meagre $1.038m.

Shadow of uncertainty

It was not only PTT that was left scratching its head. In reaching the decision, the Court of Appeal declared that:

> *… whether the liquidated damages clause (a) ceases to apply [first category] or (b) continues to apply up to termination/abandonment [second category], or even conceivably beyond that date [third category], must depend upon the wording of the clause itself.*

It then proceeded to find that Article 5.3, which appeared to be a run-of-the mill liquidated damages clause, would in fact fall away entirely upon termination, such that no liquidated damages would be recoverable if works, or a section, had not already reached practical completion (which would be the case in the majority of terminated contracts).

In so doing, the Court of Appeal introduced uncertainty into a part of many contracts which had been drafted with the specific aim of reducing uncertainty in the event of delay. For example, following the judgment, the established position under the Joint Contract Tribunal suite of contracts, a keystone of property development in the UK, was suddenly in doubt. It was far from clear whether, on the wording in the JCT contracts, an employer would be able to recover liquidated damages in the event that the contract was terminated before practical completion of the works (or a section).

Granted, that uncertainty brought with it the opportunity for parties to exploit it to their benefit, and no doubt both employers and contractors sought to do so. If the liquidated damages were less than the potential general damages, an employer may argue that the liquidated damages clause completely ceased to apply, such that it was free to pursue its (higher) general damages. Conversely, if the liquidated damages were more than the general damages, the contractor may instead make that argument. Nevertheless, in summary, the Court of Appeal's decision served to greatly reduce the commercial utility of liquidated damages clauses and deprived them of the very certainty they were intended to provide.

Supreme Court

Fortunately (albeit, perhaps, unsurprisingly) PTT appealed the decision, and on 12 November 2020, the last tango in this saga came before Lady Arden and Lords Hodge (who, also presided over *Cavendish Square*), Sales, Leggatt and Burrows in the Supreme Court. Eight months later, the United Kingdom's most senior court handed down its hotly anticipated judgment on 16 July 2021.

The Supreme Court found that the Court of Appeal had erred in its interpretation of Article

5.3, and that PTT was entitled to $3.459m in liquidated damages. Further, the Supreme Court disagreed with the lower courts' interpretation of Article 12.3, such that PTT's general damages of $11.204m in respect of termination losses were recoverable. Finally, while the cap in Article 12.3 was held to apply to liquidated damages, PTT's claim for the full liquidated damages entitlement was preserved because the delays to which the liquidated damages attached were found to be the result of Triple Point's negligence and thus excluded from the ambit of the cap in Article 12.3.

Thus, almost six and a half years after court proceedings were issued, PTT concluded the dispute with a judgment for damages in the sum of $14.664m, a 14-fold increase in the damages it had been awarded by the Court of Appeal.

Principles

In addition to that multimillion-dollar award, the Supreme Court also delivered plenty of useful legal guidance, in particular in relation to liquidated damages and caps on liability.

Liquidated damages

In circumstances where termination occurs *after* the completion date, in contrast to the Court of Appeal's view that clear words (which it considered absent from Article 5.3) were required to enable the employer to recover liquidated damages up to the date of termination, the Supreme Court held that the opposite was true. The Supreme Court cemented the orthodox position that, in the absence of clear words to alter their application, liquidated damages clauses will fall within Sir Rupert Jackson's second category, such that employer will be entitled to recover liquidated damages for the period between the completion date and termination date, and thereafter will be entitled to general damages for any losses following termination. For the Supreme Court, Article 5.3 provided neither for:

- PTT to forgo the liquidated damages that had accrued to it at the date of termination; nor
- Triple Point to be liable for liquidated damages following termination (and thus lose the protection of PTT's duty to mitigate post-termination losses).

In circumstances where termination occurs *prior to* the contractual completion date, the Supreme Court confirmed that, in the normal course, the employer will have no right to liquidated damages, which is a logical outcome. Liquidated damages will not have accrued prior to termination, as there was no delay to trigger them, and they cannot accrue following termination as the contract is at an end and the clause will no longer apply. Nevertheless, the employer can still seek to pursue a claim for general damages for any losses arising out of the termination (and any other breaches).

It should be noted, nonetheless, that the Supreme Court has left it open to contracting parties to, should they so wish, draft the contract (using clear and explicit language) so that upon termination liquidated damages either cease to apply all together (first category), or apply until a third party completes the works (third category).

Turning to the standard forms, Option Clause X7.1 of the NEC 4 Engineering and Construction Contract is clear in its pronouncement that:

> *… the Contractor pays delay damages at the rate stated in the Contract Data from the Completion Date for each day until the earlier of Completion and the date on which the Client takes over the works.*

The JCT suite does not deal quite so neatly with the liquidated damages obligations, with the assertion of the employer's right to recover them entwined with the provisions demanding that various notices be issued before liquidated damages are payable. However, it is suggested that the relevant passages (taken from the JCT Design and Build) are that if the Contractor fails to complete the Works or a Section by the relevant Completion Date' (clause 2.28) the employer may (provided it has given the necessary preceding notices) give notice that 'for the period between the Completion Date and the date of practical completion of the Works or that Section' (clause 2.29.2), the employer requires payment of, or will deduct, liquidated damages.

Following *Triple Point*, where termination occurs after the completion date, but before practical completion, it is expected that the position under the NEC 4 and the JCT contracts will be that:

- the employer will be entitled to recover any liquidated damages that had accrued at the point of termination; and
- upon termination, liquidated damages will cease to accrue, and the employer will have to recover its losses following termination by way of a claim for general damages.

Owing to the words 'earlier of Completion *and the date on which the Client takes over the works*' (emphasis added) that is likely to have been the position under the NEC 4 even after the Court of Appeal's decision, and in October 2020 the NEC published an amendment to confirm that liquidated damages ceased to accrue at the termination of the contract. However, the question over the employer's accrued liquidated damages was not so clear under the JCT suite following Sir Rupert Jackson's decision, and so the Supreme Court's judgment should restore clarity.

However, notwithstanding the Supreme Court's judgment, the impact upon liquidated damages remains an important consideration for an employer to bear in mind if it is considering termination. It must ask itself whether ridding itself of a defaulting contractor is worth forfeiting the right to continue claiming liquidated damages going forward. Might the liquidated damages exceed any potential claim for general damages? Even if they do not, does the relative simplicity of recovering liquidated damages warrant tolerating the contractor and avoiding the 'intractable task' of recovering general damages?

Conclusion

Since Triple Point commenced proceedings, six and a half years have passed, over 500 paragraphs of judicial commentary have been written and, no doubt, a frightening amount of legal fees have been incurred. However, the culmination is that contracting parties should now, and for some time to come, have confidence in how their liquidated damages clauses will operate should the worst happen, and have further helpful guidance on the interpretation of their limitation clauses.

Cap on liability

The cap on liability at Article 12.3 of the Triple Point contract contained a 'cap carve-out' in the final paragraph, such that the cap on liability did not apply to Triple Point's liability resulting from, among other things, negligence.

Each court was required to consider the meaning of the word negligence in the context of Article 12.3, with Triple Point arguing that it referred to a standalone tort, committed independently of the contractual relationship. As such, said Triple Point, a breach of a contractual term requiring the exercise of reasonable skill and care would fall outside of the cap carve-out and thus inside the cap.

The TCC and Court of Appeal agreed with Triple Point. The majority of the Supreme Court did not, and the judgments contained some useful reminders on the interpretation of clauses that cap (or exclude) liability. Lady Arden held that 'negligence' should be given its ordinary meaning which, under English law:

> *… covers both the tort of failing to use due care and the breach of a contractual provision to exercise skill and care.*

Lord Leggat reiterated that:

> *… clear words are necessary before the court will hold that a contract has taken away valuable rights or remedies which one of the parties to it would have had at common law (or pursuant to statute).*

He also cited with approval Moore-Bick LJ's statement that where a party is said to have abandoned valuable rights by the contract 'the more valuable the right, the clearer the language will need to be' (*Stocznia Gdynia SA v Gearbulk Holdings Ltd* [2009]).

Accordingly, while it was held that liquidated damages were caught by the cap, it was found that they would, nevertheless, be within the scope of the cap carve-out if they resulted from breaches by Triple Point's contractual obligations of skill and care. Therefore, because the delays were held to have been caused by Triple Point's failures to exercise reasonable skill and care, PTT's losses arising from those failures included the liquidated damages.

Cases Referenced

- Cavendish Square Holding BV v Talal El Makdessi; ParkingEye Limited v Beavis [2015] UKSC 67
- Stocznia Gdynia SA v Gearbulk Holdings Ltd [2009] EWCA Civ 75
- Triple Point Technology, Inc v PTT Public Company Ltd [2019] EWCA Civ 230

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