

Application of Delay Damages and Penalties from the Legal Point of View



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At the outset, it is important to consider the contents of clauses in connection with delay damages / penalties included in the widely used standard forms of contracts in Middle Eastern countries.

Clause 47 of the FIDIC Fourth Edition 1992 (re-printed) Red Book regulates the relationship between the employer and the contractor in case of failure by the contractor to comply with the requirement to complete work in accordance with clause 48 within the time for completion as specified in clause 43 or , if applicable, within any extended time in accordance with clause 44.

Clause 47 also provides that if the contractor fails to complete the whole or any specified section of the works by the due date, the employer may deduct or recover from the contractor the daily amount specified in the contract up to a given maximum amount. If the works are handed over on a piecemeal basis, the amount of liquidated damages is reduced proportionately.

Sub-clause 8.7 (*Delay Damages*) of the FIDIC 1999 Red Book deals with the payment of delay damages by the contractor to the employer (?) for late completion of the works (or a section of works) by reference to the time for completion of the works stated in the contract. The delay damages are calculated on a daily basis but with an upper limit, measured as a percentage of the final contract price, provided for in the Appendix to Tender. It should be noted that, even if delay damages are paid by the contractor, he is still under an obligation to complete the works or any other duties that he may have under the contract.

Though it is not a mandatory requirement for construction professionals to be fully conversant with the law, they ought to have knowledge of the legal basis behind the clauses in contracts through which they work and may

be exposed to deal with legal professionals as well. This article is written based on the English law of contract.

The Legal Nature of Damages

Damages are the legal term for a court award of monetary compensation. The object of awarding damages is normally to put the injured party in the same position they would have been in if the contract has been performed. So, the claimant is entitled to claim for what he would have expected to get if the contract had gone ahead (less any money already received). This can be contrasted with the position in the law of tort, where the aim is to put the claimant in the position which he would have been in if the tort had never been committed (pre tort position).

Claims in contracts are for actual loss. The injured party can never get more in damages than the loss which he has suffered. If the party has suffered no loss and sues he will get only nominal damages - it is not unknown for this to be as little as £ 2 – and may not get his costs. The award of damages is not to punish the party who is in breach of contract, but simply to compensate the injured party.

Distinction between Liquidated Damages and penalties

The actual description of the sum or payment is of little importance, even if the words "penalty" or "liquidated damages" are used. The distinction between the two, and the tests to be applied, have been more clearly stated in the following passage from the judgment of Lord Dunedin in *Dunlop Pneumatic Tyre Co. Ltd v New Garage & Motor Co. Ltd. (1915)*.

"1. Though the parties to a contract who use the words 'penalty' or 'liquidated damages' may prima

facie (based on a first impression) be supposed to mean what they say, yet the expression used is not conclusive. The court must find out whether the payment stipulated is in truth a penalty or liquidated damages.

2. The essence of a penalty is a payment of money stipulated as in *terrorem* of the offending party; the essence of liquidated damages is a genuine covenanted pre-estimate of damage.
3. The question of whether a sum stipulated is penalty or liquidated damages is a question of construction to be decided upon the terms and inherent circumstances of each particular contract, judged as at the time of making the contract, not as at the time of the breach.”

The limit specified in the appendix to the tender would, in the United Kingdom and other jurisdictions maintaining the penalty doctrine, provide an argument that the prescribed damages were not a genuine pre-estimate.

A penalty clause is unenforceable before the law. The aim of such a clause is to punish the party in breach and the courts have held such an aim impermissible. A clause which is held to be a penalty clause is not struck out of the contract, but it will not be enforced by the court beyond the actual loss of the party seeking to rely on the clause. (*Jobson v Johnson* (1989) 1 All ER 621. The court is not required to consider whether the party in breach is entitled to relief; the court automatically relegates the party seeking to rely on the penalty clause to a claim in damages.

Advantages of Inclusion of Liquidated Damages (LDs) Clause

The advantage of having a liquidated damages provision can be said to be that the damages payable by the contractor in culpable delay are limited and the employer who receives late completion does not have to prove his losses due to such delay. Additionally, the liquidated damages provision acts as an exhaustive remedy for damages for the late completion. Therefore, the provision provides certainty for both parties, enabling them to assess and price the risk.

Deduction of LDs

In order to decide whether liquidated damages are to be imposed, two simple questions should be asked: Has the date for completion passed? If so, is the work complete? If not, then liquidated damages are deductible. In the FIDIC Fourth Edition, this issue is complicated with reference to “Time for Completion” (Clause no.43) and the “Taking-Over Certificate” (Clause no. 48). This is because, in the typical situation where a Contractor is in a delay but disputes that it is his fault and where applications for extension of time have been submitted and he would argue that the Employer is not entitled to deduct damages, the employer would argue that when the contract is read as whole, the right to deduct is clear enough to succeed. Nevertheless, to be sure of the matter, an Employer would be well advised to clarify this issue.

Indeed, the Time for Completion is variable until the last extension of time has been granted. Further, the employer is permitted to deduct “the amount of such damages”: This phrase suggests that the total amount of the damages needs to have been established before deduction may take place. However, the employer would counter argue that sub-clause 47.1 suggests that deduction of damages should take place prior to completion based on the phrase “*The payment or deduction of such damages shall not relieve the Contractor from his obligation to complete the works,* And liabilities under the contract”.

Three more questions need to be answered by referring to Clause 47. Let us consider them now:

- Do LDs represent an exclusive remedy for the contractor’s delay of completion? Answer - Please refer to the phrase in Clause 47.1 “(which sum shall be the only monies due from the Contractor for such default)”. However, this issue is more complicated in complex projects where many subcontractors or contract packages are involved.
- Is the employer entitled to deduct the LD’s of one particular project delayed by the contractor from the monies due from other projects carried out by the same contractor? Answer – Clause 47.1 suggests that “...such damages from any monies due or to become due to the Contractor.” There is no express limitation to sums becoming due under that particular project. Thus the contractor may arguably

agree to deduct LDs from sums due under, for example, another contract with the same employer.

- Is the engineer empowered to deduct LD's from the interim certificate? Answer - No, the deduction of LDs is left strictly to the employer.

Un-liquidated Damages

When there has been a breach of contract, the injured party is entitled by common law to claim such damages as would put him 'so far as money can do it, in the same situation as if the contract had been performed.' – *Robinson v Harman (1848)*.

These damages are not pre-estimated and will be awarded by the courts.

Caparo Industries Plc -v- Dickman and others [1990]

The plaintiffs sought damages from accountants for negligence. They had acquired shares in a target company and, relying upon the published and audited accounts which overstated the company's earnings, they purchased further shares.

Held: The purpose of preparing audited accounts was to assist company members to conduct business, and not to assist those making investment decisions, whether existing or new investors in the company. The auditors did not owe a duty of care to the plaintiffs. Liability for economic loss for negligent mis-statement should be limited to situations where the statement was made to a known recipient for a specific purpose of which the maker was aware, and upon which the recipient had relied and acted upon to his detriment. The law has moved towards attaching greater significance to the more traditional categorisation of distinct and recognisable situations as guides to the existence, the scope and the limits of the varied duties of care which the law imposes. The House laid down a threefold test of foreseeability, proximity and fairness and emphasised the desirability of incremental development of the law. The test was if "the court considers it fair, just and reasonable that the law should impose a duty of a given scope upon the one party for the benefit of the other". Lord Bridge of Harwich: "What emerges is that, in addition to the foreseeability of damage, necessary ingredients in any situation giving rise to a duty of care are that there should exist between the party owing the duty and the party to whom it is owed a relationship characterised by the law as one of 'proximity' or 'neighbourhood' and that the situation should be one in which the court considers it fair, just and reasonable that the law should impose a duty of a given scope upon the one party for the benefit of the other."