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## UK Supreme Court Confirms Correct Approach to Application of Liquidated Damages Clauses When Work Not Completed

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The UK Supreme Court has recently confirmed an important principle regarding the application of liquidated damages clauses. In *Triple Point Technology, Inc v PTT Public Company Ltd*,<sup>1</sup> the Supreme Court confirmed that, as a general rule, liquidated damages will continue to accrue until such time as the parties' contract is terminated, irrespective of whether the work on the contract was ever completed. In reaching this conclusion, the Supreme Court overturned a decision of the Court of Appeal that held to the contrary – that liquidated damages did not accrue in respect of work that was never completed.

The Supreme Court's decision will be of particular interest to parties to construction contracts, given the central role played by liquidated damages for delay in managing the parties' relationship under such contracts.

### *Background*

When a party breaches a contract, it is obliged to compensate the innocent party by putting it in the same position that it would have been in had the contract been performed. Assessing the quantum of damages necessary to put the innocent party in that position can be very difficult. English law therefore allows parties to agree that, in the event of breach, one party shall pay the other a specified sum of money. Provided that the sum payable is not extravagant or unconscionable in comparison to the interest that the innocent party has in enforcing performance, the provision requiring payment of a specified sum will be classed as a liquidated damages clause and enforced by the English courts.<sup>2</sup>

Liquidated damages clauses are found in all types of commercial contracts. One very common use for liquidated damages clauses is to determine the compensation payable due to delays in a construction contract. Liquidated damages are particularly useful in this context because quantifying the employer's loss in such circumstances is extremely difficult.

### *The Dispute*

The dispute arose in relation to a contract for the implementation and provision of a software-based

business system. PTT Public Company Ltd (“PTT”) is in the business of commodity trading. It entered into a contract with Triple Point Technology, Inc (“Triple Point”) for the design, installation, maintenance and licensing of software to assist PTT in carrying on its business. The work was to be carried out in two phases, each of which had nine stages. The contract contained a liquidated damages clause, which obliged Triple Point to pay liquidated damages of 0.1% of the contract price per day of delay for each item of undelivered work.

The project suffered from very substantial delays. The outcome was that only the first two stages under Phase 1 were completed; these two stages were completed 149 days late. The other seven stages for Phase 1 were not completed, and no work whatsoever was carried out in respect of Phase 2. PTT subsequently gave notice of termination.

### *The Decision at First Instance*

Proceedings were commenced in the Technology and Construction Court. In a judgment handed down on 23 August 2017, Mrs Justice Jefford held that Triple Point had breached the contract by failing to exercise reasonable skill, care and diligence in the performance of its services, contrary to Article 12.1 of the contract. She awarded liquidated damages in the amount of \$3,459,278.40. For the two stages that had been completed, liquidated damages were assessed based on the difference between the date on which the work ought to have been completed and the date on which it was actually completed. For the 16 stages that had not been completed (seven for Phase 1 and nine for Phase 2), liquidated damages were assessed based on the difference between the date on which the work should have been completed and the date of termination.<sup>3</sup> Triple Point appealed to the Court of Appeal.<sup>4</sup>

### *The Decision of the Court of Appeal*

The Court of Appeal held that PTT was only entitled to liquidated damages in respect of the two stages that had been completed at the time of termination of the contract. Therefore, no liquidated damages were payable with respect to the seven remaining stages for Phase 1 or any of the nine stages for Phase 2. The Court of Appeal accordingly awarded only \$154,662 in respect of liquidated damages – less than 5% of the amount awarded by the first instance judge.

The sole judgment of the Court of Appeal was given by Sir Rupert Jackson. Sir Rupert reviewed the authorities on the applicability of liquidated damages clauses. He found that, in circumstances where the contractor fails to complete the works and it is necessary for a second contractor to step in, three different approaches to the payment of liquidated damages have emerged:

1. The liquidated damages clause does not apply;
2. The clause applies, but only up to the termination of the contract;
3. The clause continues to apply until the second contractor has completed the works.

Sir Rupert Jackson noted that option 2 was generally treated as “the orthodox analysis,” but considered that this approach was not “free from difficulty.”<sup>5</sup> Sir Rupert Jackson subsequently decided to apply option 1. His rationale was (i) that the contract specifically states that liquidated

damages should run from the due date up to the date of acceptance; and (ii) the House of Lords had applied option 1 when confronted with very similar language in *British Glanzstoff Manufacturing Co Ltd v General Accident, Fire and Life Assurance Corporation Ltd*.<sup>6</sup>

PTT appealed to the Supreme Court.

### *The Decision of the Supreme Court*

The Supreme Court decided, unanimously,<sup>7</sup> that the Court of Appeal was wrong and that the first instance judge had decided the liquidated damages issue appropriately. The correct approach was for liquidated damages to be payable in respect of all delays prior to the termination of the contract (i.e. option 2 above). It accordingly held that liquidated damages were payable in respect of all stages of Phase 1 and Phase 2, not just those that had been completed at the time the contract was terminated. It therefore awarded PTT \$3,459,278.40 in respect of liquidated damages.

The Supreme Court gave a number of reasons why it considered the Court of Appeal's analysis to be flawed. The leading judgment was given by Lady Arden. She began by reference to authority. She pointed out that the Court of Appeal had, after conducting a detailed survey of the authorities, quite knowingly departed from the position that had been applied in the majority of those cases.<sup>8</sup> The established position was Sir Rupert Jackson's option 2: a liquidated damages clause applied in respect of all delays until the contract was terminated, but did not apply to losses suffered thereafter.

Lady Arden continued her analysis by referring to principle. She noted that the Court of Appeal had focused very closely on the wording of the liquidated damages clause, and in particular the phrase "*from the due date for delivery up to the date PTT accepts such work*". She held that the approach adopted by the Court of Appeal was inconsistent with both commercial reality and the accepted function of liquidated damages. Parties agreed to include a liquidated damages provision in order to provide a remedy that was predictable and certain. It was widely accepted that liquidated damages clauses applied up until the termination of a contract, but not thereafter.<sup>9</sup> Therefore, by including a liquidated damages clause, the parties should be taken to have intended precisely these consequences to obtain.<sup>10</sup> Lady Arden went on to hold that the better way of interpreting the language quoted above was as providing that, in the event the work was accepted, there was to be no further claim for liquidated damages. It should not be interpreted as providing that, in the event there was no acceptance, no liquidated damages would be payable.<sup>11</sup>

Lady Arden supported this conclusion by reference to two further points. First, the law should protect the accrued right to liquidated damages.<sup>12</sup> Second, the approach adopted by the Court of Appeal was commercially unreasonable, because there was no good reason why two parties would want liquidated damages for delay to apply only in one set of circumstances, but not in all other circumstances where the completion of the work was delayed.<sup>13</sup>

Lady Arden concluded the relevant part of her judgment by dismissing Sir Rupert Jackson's other reason for choosing option 1. She held that the decision in *Glanzstoff*, on which Sir Rupert Jackson had relied, should not be treated as binding. Far from being a case of significance that established a point of principle, she held that it was in fact simply a case that turned on its particular facts.<sup>14</sup>

Lord Leggatt gave a further reason why the Court of Appeal's approach should not be adopted. He noted that the Court of Appeal's chosen interpretation of the clause created perverse incentives. He pointed out that, if payment of liquidated damages was dependent on the contractor completing the work (and that work being accepted by the employer), this would give the contractor an incentive not to complete the work at all. The contractor would be able to avoid the guaranteed liability to pay liquidated damages simply by stopping work. In Lord Leggatt's view, it would make no sense to create such an incentive.<sup>15</sup>

## Conclusions

The English law position with regard to liquidated damages has undergone upheaval in recent years. This upheaval was most pronounced in the decision of *Cavendish Square Holdings BV v Talal El Makdessi*, where the Supreme Court held that the established test for determining whether a particular clause was a liquidated damages clause or a penalty clause – that of a “genuine pre-estimate of loss” – actually formed part of a much broader test.<sup>16</sup>

The decision in *Triple Point Technology v PTT Public Company* should not cause similar upheaval. The Supreme Court in the instant case re-established what had long been thought to be the position of English law with regard to the interaction between termination of a contract and payment of liquidated damages. The Supreme Court has demonstrated that, unless the clause in question specifically provides to the contrary, liquidated damages will be assessed up to the date of termination, even in circumstances where specific items of work were never completed.

The decision of the Supreme Court is to be welcomed. Parties that agree liquidated damages clauses generally do so in order to obtain certainty as to the damages that will be payable should a particular event take place. Applied to the context of delayed performance, this will generally mean that they will intend liquidated damages to be payable in respect of all delays that occur, until such time as (i) the work is completed; or (ii) the contract is terminated.<sup>17</sup> It makes little sense for a court to assume that the parties would have intended liquidated damages only to be payable in certain circumstances, but not others. Therefore, absent clear language to the contrary, it is consistent with the expectations of rational businessmen to interpret liquidated damages clauses as the Supreme Court has done.

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<sup>1</sup> *Triple Point Technology, Inc v PTT Public Company Ltd* [2021] UKSC 29 (hereinafter “Judgment of the Supreme Court”).

<sup>2</sup> In circumstances where (i) the innocent party did not have a legitimate interest in ensuring performance; or (ii) it did have a legitimate interest but the sums payable in the event of breach were found to be extravagant or unconscionable in comparison to that interest, the clause would be classed as a penalty clause and deemed unenforceable. In such circumstances, it becomes necessary to assess damages in the normal way. See *Cavendish Square Holding BV v Talal El Makdessi* [2015] UKSC 67.

<sup>3</sup> *Triple Point Technology, Inc v PTT Public Company Ltd* [2017] EWHC 2178 (TCC), paras. 263-270. The judge also determined that PTT should have been entitled to further damages amounting to

approximately \$11.2 million. The large majority of this sum related to the need to employ a replacement contractor to complete the works. Jefford J went on to hold, however, that Triple Point's liability was limited to just over \$1 million by a liability cap in the contract. This finding was appealed to both the Court of Appeal and Supreme Court. Given that this issue turned purely on the interpretation of the contract and has no broader significance, it is not discussed further here.

<sup>4</sup> PTT cross-appealed with regard to the application of the liability cap.

<sup>5</sup> *Triple Point Technology, Inc v PTT Public Company Ltd* [2019] EWCA Civ 230, para. 110.

<sup>6</sup> *British Glanzstoff Manufacturing Co Ltd v General Accident, Fire and Life Assurance Corporation Ltd* [1913] AC 143.

<sup>7</sup> Lord Sales and Lord Hodge dissented on another issue in dispute, namely the applicability of the liability cap. However, the Supreme Court was unanimous when it came to the scope of the liquidated damages clause.

<sup>8</sup> Judgment of the Supreme Court, para. 34.

<sup>9</sup> General damages could, of course, still be sought with respect to delays suffered post-termination.

<sup>10</sup> Judgment of the Supreme Court, para. 35.

<sup>11</sup> Judgment of the Supreme Court, para. 48.

<sup>12</sup> Judgment of the Supreme Court, para. 37.

<sup>13</sup> Judgment of the Supreme Court, para. 38.

<sup>14</sup> Judgment of the Supreme Court, paras. 42-47.

<sup>15</sup> Judgment of the Supreme Court, para. 81.

<sup>16</sup> *Cavendish Square Holding BV v Talal El Makdessi* [2015] UKSC 67. As noted at the outset, English law now asks whether the party seeking to obtain payment has a legitimate interest in enforcing performance, and whether the amount payable is extravagant or unconscionable in comparison to that interest.

<sup>17</sup> Once the contract has been terminated, the primary obligations under the contract are no longer in force and are instead replaced by secondary obligations to pay compensation: *see e.g. Photo Productions Ltd v Securicor Transport Ltd* [1980] AC 827, 849.

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## *Authors*



**Michael Howe**

**COUNSEL**



[michael.howe@wilmerhale.com](mailto:michael.howe@wilmerhale.com)



+44 (0)20 7872 1032