

## Liquidated Damages Clauses - Enforceability

*Multiplex Constructions Pty Limited v Abgarus Pty Limited & Anor*, unreported, Supreme Court of New South Wales, Cole J, 25 August 1992.

In probably one of the most significant cases impacting upon the construction industry, Mr Justice Cole of the Supreme Court of New South Wales has closely examined the relevant principles to be applied when assessing the validity of liquidated damages clauses in the context of major construction projects.

Proceedings were commenced by the builder against the proprietor seeking declaratory orders that a liquidated damages clause which had been drafted as a substitute for the standard liquidated damages clause in the JCCA - 1985 form of contract, was penal in nature and thereby unenforceable.

The decision considered a number of important issues relating to liquidated damages clauses generally, however it is proposed to focus on the two most critical issues arising out of the decision:

1. the appropriate formula for the measure of damages in liquidated damages clauses for major construction projects;
2. the admissibility of evidence relating to negotiations and discussions for the contract as a whole, and the liquidated damages clause in particular, in assessing the validity of the liquidated damages clause.

In relation to the first issue Cole J said:

"The principle in issue between the proprietor and the builder is one of great importance to those engaged in the construction and development industries. The point may be expressed as follows:

Whether a clause in a building contract for the construction of a high rise commercial builder, which clause requires the builder to pay a proprietor's holding costs during the period of delay attributable to the builder in achieving practical completion beyond the contractual date for practical completion, fails as being a penalty."

The relevant liquidated damages clause between the parties was based upon the proprietor's holding costs over the period of any delay and relevantly provided that the builder pay to the proprietor as liquidated and ascertained damages interest at a prescribed rate on the following items of capital expenditure:

- (i) \$30,000,000.00 being the value of the site at the date of this agreement.
- (ii) Payments made by the Proprietor under any contract relating to the execution of the

Works.

- (iii) Preliminary expenses incurred by the Proprietor.
- (iv) Rates and taxes and other statutory charges assessed against or incurred by the Proprietor in connection with the site or the Works.
- (v) Reasonable costs and expenses incurred by the Proprietor in enforcing or attempting to enforce any contract relating to the execution of the works.
- (vi) Reasonable costs and expenses incurred by the Proprietor in insuring the Works.
- (vii) Fees paid to architects, surveyors, engineers, consultants, project managers and other experts engaged in the execution of the Works.
- (viii) Salaries paid to the building clerks of the Works and mechanical clerks of the Works.
- (ix) All other costs and expenses incurred by the Proprietor which were reasonably necessary to the execution of the Works.
- (x) Interest at a rate per annum equal to the maximum rate of interest then charged by major Trading Banks on overdraft accounts over \$100,000.00 calculated on daily balances on the amounts referred to in items (i) to (ix) above inclusive from the respective dates upon which any such amounts were expended by the Proprietor. Such interest shall be capitalised on 31 December in each year prior to the Date for Practical Completion of the Works.
- (xi) All rates, statutory charges and other reasonable outgoings in respect of the Works and the site assessed against or incurred by the Proprietor in respect of the period commencing at the date so stated by the Architect and finishing when the Works reach Practical Completion."

The builder argued that the appropriate measure of delay was "deprivation of the revenue stream either from the sale or lease of the building, not the holding charges incurred ..." The builder asserted that the loss which the proprietor would suffer for delay was delayed cashflow, upon the basis that "If the proprietor were to retain the project after completion it would have the total holding costs in any event and its loss would be merely delayed cashflow from rentals. On the other hand if the building was to be sold on completion, similarly the proprietor

would have the holding costs until sale of the project which would be delayed by any delay in practical completion.” By focusing on the proprietor’s holding costs, the builder claimed that the clause was a completely inappropriate test for the measurement of or the making of a genuine pre-estimate of damage suffered by the proprietor for delay.

Cole J considered that this argument presented a number of practical commercial difficulties and identified three specific problems which would result to the parties if the argument were accepted:

1. It would become obligatory upon the proprietor and the builder “to make an assessment, and to agree upon an assessment, either of rentals or a formula for determining rentals at the date when practical completion was expected to be achieved under the contract”.
2. “Second, if it be that the proprietor may contemplate sale of the building once completion is achieved, as distinct from retention and leasing in its own hands, it would be necessary for the builder to obtain advice regarding the estimated value likely to be realised on re-sale upon completion in accordance with the contract practical completion date”.
3. His Honour drew a comparison with works of a public nature, such as dams or major road works, where generally public works do not yield a cashflow. In these situations, if the builder’s argument were correct, then because public works do not yield a cashflow, a liquidated damages clause could never operate in a contract for the construction of public works.

His Honour then considered the various stages of a development project for a high rise office building and the considerations of the parties relevant to each stage and found that the parties to a construction contract contemplate at the time of signing the contract that a delay in achieving practical completion will necessarily result in additional holding costs. His Honour noted that no authority was identified in which the question of the validity of a damages clause based upon the holding costs for the period of delay on a major construction contract was considered and after reviewing some related authorities and texts said:

“... I am satisfied that a clause which specifies as liquidated damages in respect of a major city building the accumulated costs of the proprietor to date of contractual practical completion and determines the holding charges of those costs for any period of delay occasioned by the builder constitutes a valid, enforceable liquidated damages clause ...”.

Justice Cole’s decision is probably the first decision which addresses specifically the proper formula for liquidated damages in major construction projects. The decision rejects the proposition that a liquidated damages clause should focus on loss of income caused by delay and accepts that the proper measure of damages is additional

holding costs, even though those holding costs may have been incurred by the proprietor in any event.

The second critical issue discussed in the decision was the admissibility of evidence of negotiations between the parties prior to the signing of the contract. His Honour admitted into evidence negotiations between the parties and their legal representatives formulating the liquidated damages clause as being relevant to the overall question of whether the clause was penal. His Honour said in admitting the evidence:

“There is, in my view, a qualitative difference of which the law is able to take account between a clause freely negotiated between major commercial organisations, in respect of a substantial contract, where the major commercial organisations have available and receive competent legal advice regarding the meaning, purpose and likely consequence of the clause, from a clause attacked as a penalty in a contract of adhesion between a major organisation and an individual or small company which has, in reality, no opportunity to negotiate the contract.”

It is clear from this statement that the Courts will in the future regard as a relevant consideration the nature of the project, the nature of the contract and the relative bargaining positions of the parties when assessing the validity of liquidated damages clauses.

An appeal has been lodged by the builder against the decision, however it is not expected that the appeal will be heard until some time in late 1993.

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