

Supreme Court clarifies approach to liquidated damages clauses

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The dispute

In 2013, PTT (a commodities trader) entered into a contract with Triple Point (a designer and developer of software) for design and implementation of a customised software system for commodity trading and risk management.

Triple Point fell into delay in Phase 1, which was completed 149 days late. It then submitted invoices in respect of incomplete work in Phase 2, in reliance on payment dates stipulated in order forms. PTT refused to pay invoices in respect of Phase 2 on the basis that the Phase 2 milestones had not been met. Triple Point did not dispute that it had missed milestones, but suspended further work until payment was made. PTT alleged that Triple Point was in repudiatory breach, which it accepted as terminating the contract.

Article 5.3 of the contract provided, in respect of 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 percent) of undelivered work per day of delay from the due date for delivery up to the date PTT accepts such work"

The contract also provided a cap on Triple Point's liability to PTT at clause 12.3 as follows:

"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 and 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 CONTRACTOR 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."

Triple Point issued proceedings in the TCC claiming sums due under its unpaid invoices; PTT counterclaimed for damages in respect of its losses arising from the termination and liquidated damages in respect of the delays.

The decisions below

At first instance, the Court dismissed Triple Point's claims. The Court also held that PTT was entitled to liquidated damages of c.\$3.5m which had accrued under Article 5.3 prior to termination, and that those liquidated damages did not fall within the liability cap at Article 12.3. Triple Point appealed to the Court of Appeal. PTT's termination losses (c.\$10.5m) and wasted costs were found to be subject to the liability cap.

The Court of Appeal found that PTT was only entitled to liquidated damages in respect of work which had been completed prior to termination. In reaching that finding, the Court of Appeal reviewed a number of earlier decisions and found 3 possible ways to interpret liquidated damages clauses in circumstances where the contract is terminated before the work is completed: (1) the liquidated damages do not apply to any of the delay; (2) the liquidated damages apply to any delay occurring up to the date of termination; (3) the liquidated damages apply to any period of delay up to the completion of the work.

The Court of Appeal found that the liquidated damages clause in this case fell into the first category. In doing so, it relied upon the wording of Article 5.3, which stated that liquidated damages were payable "*up to the date PTT accepts such work*", which it interpreted as meaning that PTT was not entitled to recover liquidated damages as the work had not been completed nor accepted.

The Court of Appeal also held that PTT's liquidated damages claim fell within the total damages recoverable under the liability cap, on the basis that the exclusion from the cap in the final sentence of clause 12.3 ("This limitation of liability shall not apply to CONTRACTOR's liability resulting from...negligence") applied only to freestanding torts of negligence and not negligent breach of a contractual duty of care.

The Court of Appeal's decision was considered controversial by many, as it set a precedent for the entitlement to liquidated damages in respect of delay accruing up until completion to fall away in circumstances where the contract is terminated before the work is completed. This could result in the contractor benefiting from its own breach, with the customer's right to liquidated damages expiring on termination and the customer then having to prove loss and causation in a claim for general damages.

The Supreme Court's decision

Three issues were appealed to the Supreme Court:

1. whether PTT was entitled to liquidated damages in respect of the uncompleted phase 2 works up to the date of termination, or whether it was only entitled to liquidated damages for work completed by the date of termination;
2. whether, on a proper interpretation of the liability cap, the carve-out relating to "negligence" meant that losses caused by Triple Point's negligent breach of contract were not subject to the cap on liability; and
3. whether claims for liquidated damages were subject to the liability cap at all.

In relation to the liquidated damages issues, the Supreme Court held that the Court of Appeal had departed from the generally understood position that, subject to the precise wording of the clause, liquidated damages would accrue until the contract was terminated, even where the work was never completed. The words "up to the date PTT accepts such work" simply provided a long-stop date for the payment of liquidated damages, and did not mean that liquidated damages only applied where the work was accepted. Following the Court of Appeal's approach would be inconsistent with commercial common sense and the accepted function of liquidated damages.

The Supreme Court found:

"Parties agree a liquidated damages clause so as to provide a remedy that is predictable and certain for a particular event (here, as often, that event is a delay in completion). The employer does not then have to quantify its loss, which may be difficult and time-consuming for it to do. Parties must be taken to know the general law, namely that the accrual of liquidated damages comes to an end on termination of the contract. After that event, the parties' contract is at an end and the parties must seek damages for breach of contract under the general law. That is well-understood."

Further, the Supreme Court confirmed (unanimously) that the liability cap encompassed liquidated damages (except those related to Triple Point's negligent breach of contract), so that the liquidated damages fell within the maximum damages recoverable under the cap.

In relation to the negligence carve-out, the Supreme Court held (by majority) that the natural meaning of "negligence" includes all forms of negligence, not only "free-standing" torts. In reaching that finding, the Supreme Court noted that the starting point for interpreting contractual provisions is the assumption that in the absence of clear words to the contrary, the parties did not intend to depart from the normal rights and obligations established by the common law, and that it would be "incoherent and inappropriate to interpret the carve-out by reference to unrealistic examples of independent torts".

Conclusion

The decision provides welcome clarity on the application of liquidated damages provisions where the contract is terminated before the work is completed by the original contractor. If parties intend that the entitlement to liquidated damages should be extinguished where works are never completed, it is open to them to do so by including express wording to that effect in their contract, but in the absence of such wording the entitlement will survive up until termination.

If you are the customer in such a situation, and find that the liquidated damages provisions in your contract are set lower than is necessary to cover your losses while the contractor completes the works, you may now consider it preferable to terminate the contract at the earliest opportunity after delays arise, in order to claim general damages. For contractors, the opposite scenario may apply, weighing in favour of doing everything possible to keep the contract alive in order to avoid delay claims falling within the scope of general damages. Every case will, of course, turn on its own facts. If you require assistance with reviewing your position and options available, please contact [Sophie Ashcroft](#).

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