

Liquidated Damages – The Builder’s Bane

A liquidated damages (LD) clause sets out an amount, on a daily or a weekly basis, the builder must pay the owner for late completion.

However, a LD clause that is a “penalty” against the builder for late completion will not be enforced by the Courts. A contract stipulating that a builder in breach will pay an agreed sum to the owner – which is more than a genuine pre-estimate of damage likely to be suffered by the innocent party as a consequence of the breach – is a penalty.

A valid LD clause must be a *genuine pre-estimate when the transaction was entered into* (the contract was signed) of the damages likely to be suffered by the innocent party. When the amount to be imposed is in excess of the maximum amount of damage conceivable so as to be totally out of proportion, the LD clause may be considered to be a penalty, and therefore unenforceable.

In *State of Tasmania v Leighton Contractors Pty Ltd* (2005), the contract involved the design, construction and maintenance of a highway. In the event of non-completion by a nominated date, \$8,000 per day could be withheld from Leighton. The highway was due to be completed in April

2001 but was not handed over until November that year.

At trial Leighton argued that the LD clause was a penalty and the trial judge agreed as “it does not appear that any estimation was made in respect of the (State’s) loss other than direct costs of an over-run contract”

On appeal the Full Court of the Supreme Court of Tasmania disagreed, identifying the question as whether, given the nature of the contract, its complexity, value and the bargaining strength of the parties, \$8,000 per day was in all the circumstances, a penalty as at the date of the contract. The test was whether as at that date, the sum was so disproportionate that it provided not for ‘liquidated damages’, but operated as a penalty against a contracting party.

Apart from the fact that Leighton did not object to the LD clause, the Full Court found that \$8,000 per day was not an unreasonable estimate of the loss

and damage likely to be suffered by the State in the event of late completion of the highway.

In a domestic context, heads of damage likely to be suffered by an owner as a result of late completion by the builder are additional interest paid on borrowed funds and additional rent paid for alternative accommodation.

Therefore, provided that the sum shown in the contract as the sum payable as LD is a reasonable estimate of the likely loss to be suffered by the owner *as at the date the contract was signed*, that sum will not be considered to be a penalty against the builder.

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