

**THE 8TH INTERNATIONAL
SOCIETY OF CONSTRUCTION LAW CONFERENCE
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**CONSTRUCTION LAW:
LOCAL ISSUES - GLOBAL PERSPECTIVES**

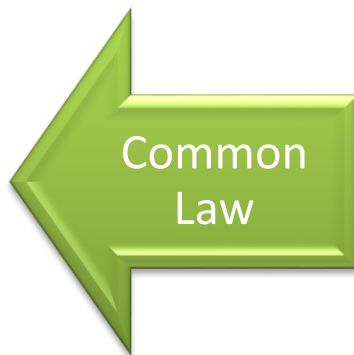
Keynote

Navigating penalties and liquidated damages across
common law and civil law jurisdictions

Professor Doug Jones AO

Overview

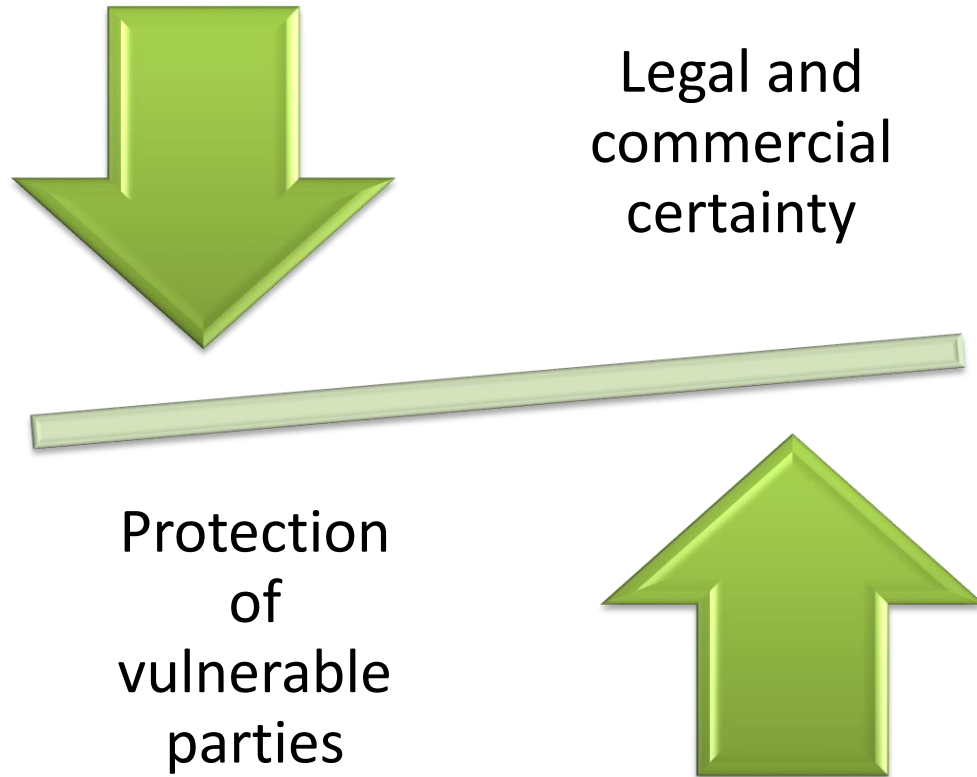
1. Context to liquidated damages
2. Development in **common law** jurisdictions
3. The position in **civil law** jurisdictions
3. **Evaluation** of common and civil law approaches



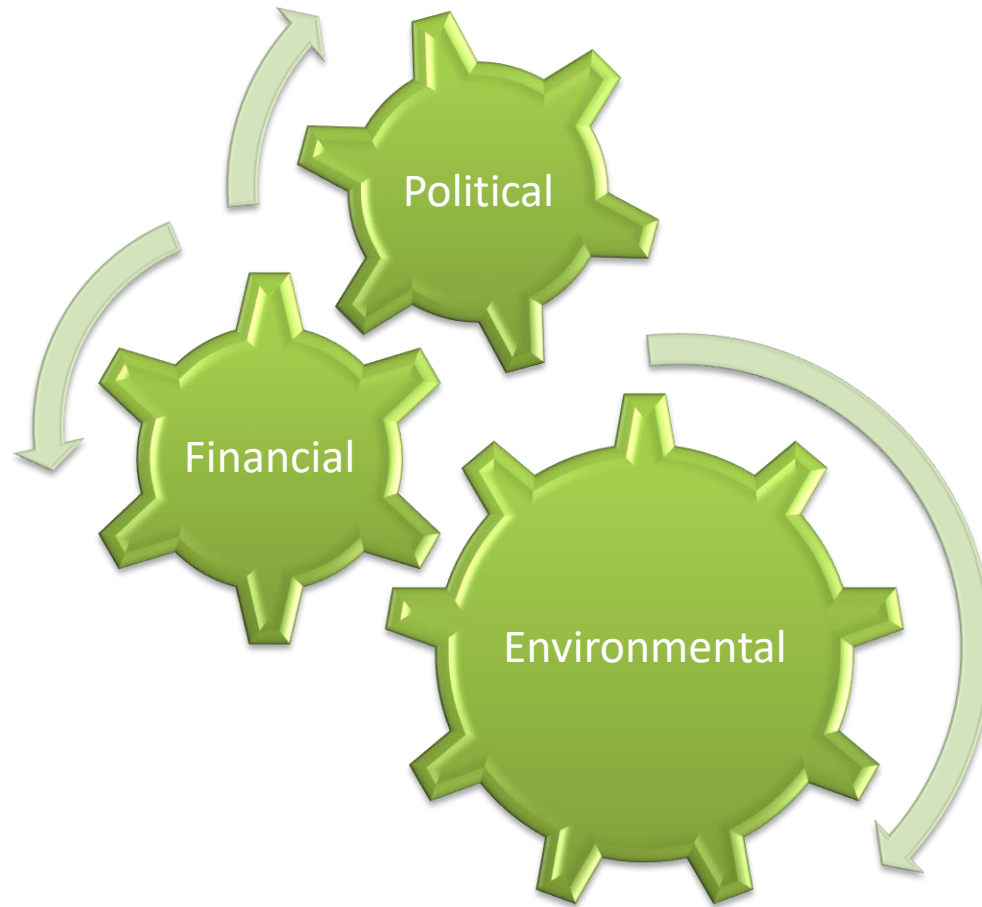
Part I: Context to Liquidated Damages

- The penalty rule operated as a form of relief from defeasible bonds in the 15th and 16th centuries
- Bond holders could claim for an amount often significantly more than their actual losses
- Equity saw the intention of these bonds as security only and reduced their enforcement

Historical Background



The value of fixed sum damages in construction law



Part II: Development in Common Law Jurisdictions

- Development of the law in England
- Divergence from English doctrine
- Other common law jurisdictions

Development of the law in England

1915 *Dunlop Pneumatic Tyre Co Ltd v New Garage Motor Co Ltd*

- A clause will be held to be a penalty if the sum stipulated is ***extravagant and unconscionable*** in comparison with the greatest loss that could conceivably be proved to have followed from the breach

2015 *Cavendish Square Holding BV v Talal El Makdessi; ParkingEye Limited v Beavis*

- The true test is whether the impugned provision is a ***secondary obligation*** which ***imposes a detriment*** on the contract-breaker ***out of all proportion*** to any ***legitimate interest of the innocent party*** in the enforcement of the primary obligation

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Divergence from English Doctrine



United States

- Liquidated damages clause only valid when damages are uncertain or difficult to prove
- Reasonableness of the clause can be considered at the time of contracting or at the time the breach transpired



Canada

- Unconscionability is the underlying rationale for penalties adopted in a line of Canadian cases
- This was rejected by *Cavendish* which leaned towards economic efficiency and commercial justifications



Australia

- After *Andrews*, the High Court found that the penalties rule still existed in equity and does not require a breach of contract
- The scope of the penalties doctrine was significantly expanded to potentially any contractual stipulation

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Other common law jurisdictions

- India, Malaysia Tanzania and Brunei
 - » No distinction between penalties and liquidated damages
 - » No general right to receive the agreed amount upon occurrence of a breach

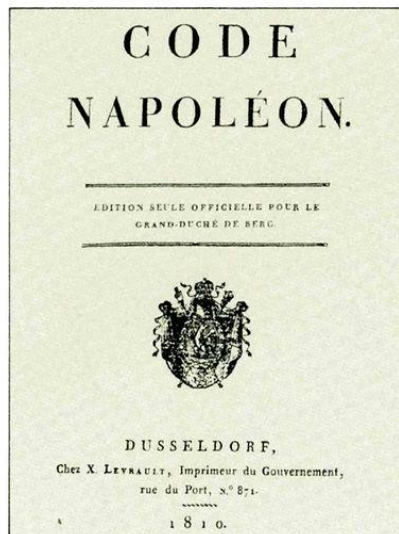
- Two consequences:
 - » The injured party must prove their actual losses up to the limit; and
 - » If this is not possible, the court can award 'reasonable compensation' not exceeding the amount agreed to by the parties.

Part III: Position in Civil Law Jurisdictions

- Two crucial distinctions:
 - » Civil law **presumes the enforceability of penalty clauses** as a valid means of compelling performance. Therefore, little distinction between penalty clauses and liquidated damages clauses; and
 - » Courts and arbitrators applying civil law have the authority to **adjust an amount stipulated as a penalty**. The common law option is merely to enforce the clause or not.

History

- Penalty clauses in civil law have their roots in the Napoleonic Code
- 1971 Council of Europe resolution aimed to unify the application of penalty clauses for member states



French Civil Code *Article 1231-5*



"Where a contract stipulates that the person who fails to perform shall pay a certain sum of money by way of damages, the other party may be awarded neither a higher nor a lower sum.

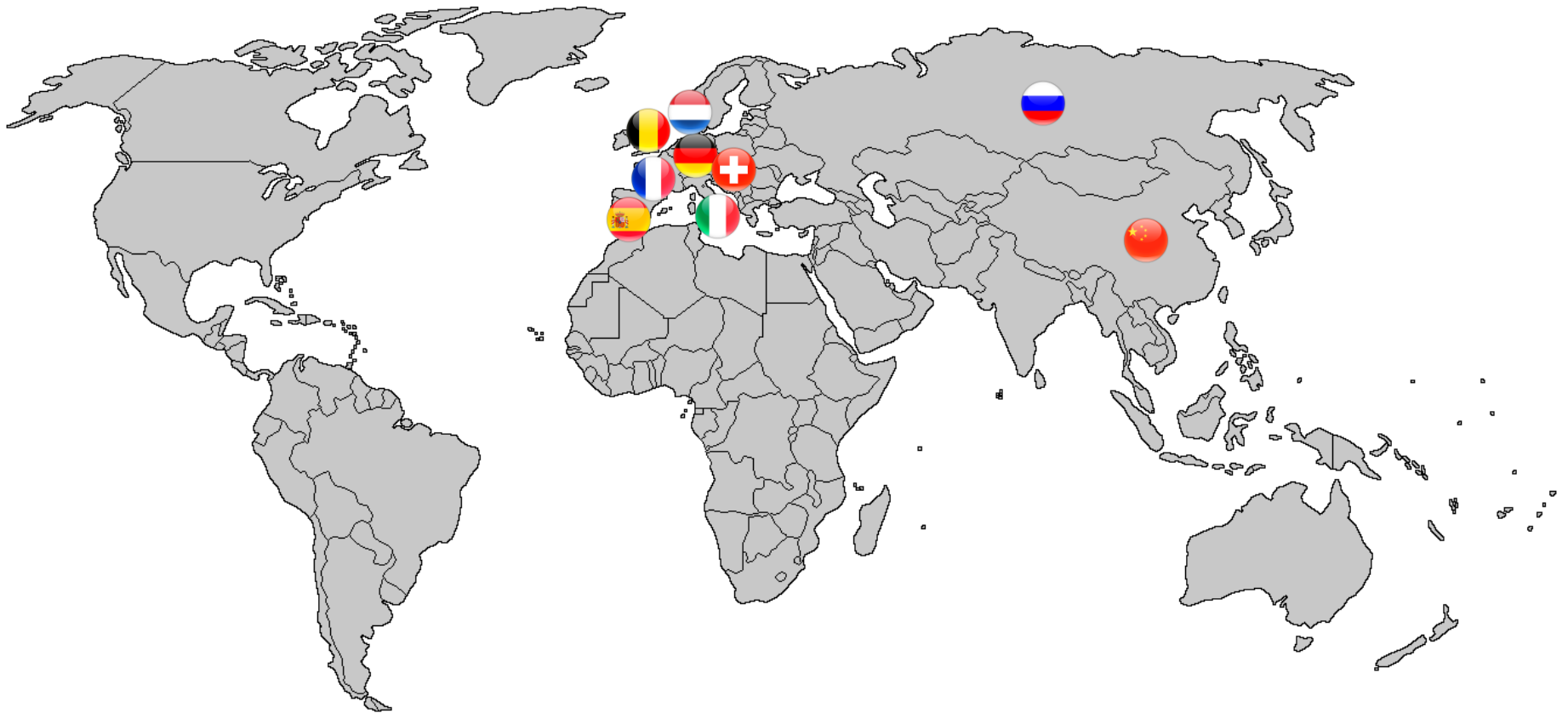
Nevertheless, a court may, even of its own initiative, moderate or increase the penalty so agreed if it is ***manifestly excessive or derisory***.

Where an undertaking has been performed in part, the agreed penalty may be reduced by a court, even of its own initiative, ***in proportion to the advantage which partial performance has procured for the creditor***, without prejudice to the application of the preceding paragraph.

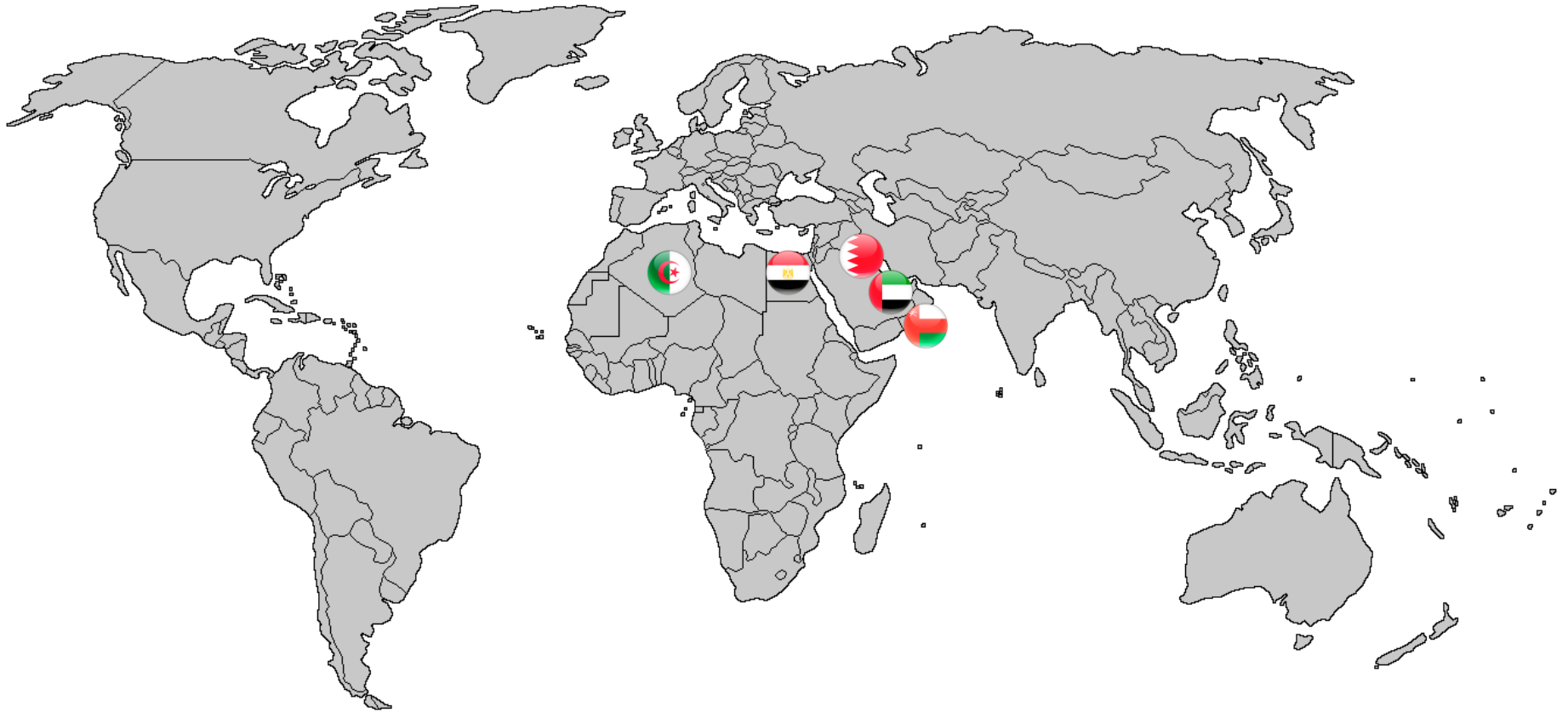
Any stipulation contrary to the preceding two paragraphs is deemed not written.

Except where non-performance is permanent, a penalty is not incurred unless the debtor was put on notice to perform."

Operation



Operation



Part IV: Evaluation of Approaches

- Choice of governing law in international contracts is vital to consider, given divergent approaches between jurisdictions
- Select a legal framework which delivers contractual certainty and is non-interventionist
- Standard form contracts such as the FIDIC suite accommodate a wide range of governing laws
- The validity of liquidated damages will be one of many considerations in choice of law

Which pathway to follow?

Common Law

- In light of the *Cavendish* decision, the English approach can provide a sensible commercial outcome
- The Australian decision in *Andrews* has received much criticism

Civil Law

- The court will often be required to look at the actual losses suffered, which requires cogent evidence
- However, courts have the ability to modify the amount of liquidated damages claimed

Potential for improvement in the common law word?

- It is hoped that other common law jurisdictions will adopt the English position
- This will create greater certainty in the drafting of contracts governed by common law jurisdictions
- Lessons can be learnt by the common law from the civil law such as the option to modify the rate of liquidated damages awarded

Concluding Remarks

1. Divergent approaches require careful navigation
2. Courts should champion flexibility and build on the *Cavendish* decision
3. The ability to adjust liquidated damages in civil law may be worth considering

Professor Doug Jones AO

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