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LIQUIDATED DAMAGES CLAUSES – PENALTY OR GENUINE ESTIMATE OF LOSS?

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Construction contracts, particularly the Australian Standard general conditions, routinely include liquidated damages clauses requiring one party to pay damages arising from some breach of contract or a defect. Such terms will be unenforceable as a penalty clause if the amount does not represent a genuine pre-estimate of the loss the non breaching party will incur as a result of the breach.

The Supreme Court of Queensland was recently asked to consider a modified AS4300-1995 general conditions contract and determine whether or not the liquidated damages clause was a penalty clause. The Court in *Grocon Constructors (Qld) Pty Ltd v Juniper Developer No. 2 Pty Ltd*, held the liquidated damages clause was enforceable and its reasoning is helpful for all parties negotiating and drafting liquidated damages clauses in construction contracts.

THE DISPUTE

Juniper Developer No. 2 Pty Ltd ("**Juniper**"), as owner of a development site in Surfers Paradise, entered into a modified AS4300-1995 with Grocon Constructors (Qld) Pty Ltd ("**Grocon**") as builder. The contract provided for four separable portions in respect of the development. Grocon commenced proceedings against Juniper for unpaid monies and delay costs and Juniper counterclaimed for $33.6 million in unliquidated damages. The claim for liquidated damages was alleged to have been triggered by a failure to achieve practical completion for each of the separable portions.

The definition of "Practical Completion" in the AS4300-1995 had been amended by the parties to include matters such as delivering two sets of keys for the works fitted with plastic tags, all rubbish removed from site and "the works be free from all identifiable omissions and defects".

The range of damages for each separable portion varied from $8,500 per day to $59,000 per day and had been the subject of correspondence between the parties prior to agreement being reached on these amounts for the unliquidated damages rate.

In defence of the counterclaim, Grocon argued that the definition of "Practical Completion" meant it could be liable for substantial damages even if the defect was trivial in nature. This, it argued, indicated that the liquidated damages clause was a penalty because the substantial liquidated damages for each day was out of proportion with the loss to Juniper as a result of that defect.

THE DECISION

Grocon's arguments were rejected on the basis that:

1. it was not the individual breaches and defects which were relevant for assessing the proportionality of the liquidated damages sum. Rather, the presence of those defects prevented practical completion taking place pursuant to the terms of the contract and it was that failure

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against which the reasonableness of the liquidated damages sum was to be assessed; and

2. in assessing whether or not the liquidated damages claim represented a genuine pre-estimate of loss, the Court found the following were relevant:

   (a) the parties had paid particular attention to the liquidated damages clause and Juniper had issued correspondence to Grocon when negotiating the terms of the contract which identified what it considered would be its loss if practical completion was not achieved by the required date. It included a breakdown of those losses such as finance and other costs Juniper would incur if practical completion was delayed;

   (b) Grocon's failure to achieve practical completion had the effect that Juniper was not able to settle its sale contracts with purchasers. In such circumstances, the agreed liquidated damages was a genuine attempt to pre-estimate the loss Juniper could suffer as a result of not settling with purchasers; and

   (c) the parties were commercially sophisticated and equal in bargaining power at the time of negotiating and executing the contract.

This decision turned largely on evidence of the negotiations between Grocon and Juniper. There was clear evidence that Grocon had been provided with detailed information identifying what losses Juniper expected it would incur if there was delay in practical completion in the context of negotiating the liquidated damages clause.

LESSONS

The lessons which can be taken from this decision are as follows:

1. Documentation is critical to assist in proving the reasonableness of liquidated damages. To the greatest extent possible, parties should ensure all negotiations of contractual terms are done in writing and retained in case there is a dispute.

2. Care should be taken in drafting clauses which trigger liability to liquidated damages to ensure all eventualities are provided for in the contract. As identified above, the parties in this decision took particular care to identify a number of things required of Grocon before practical completion would be reached.

3. Justifying a position that liquidated damages is not a penalty clause is greatly assisted where the parties have been transparent during the negotiation of the contract. It must be shown that genuine attempts to pre-estimate the loss have been undertaken by the parties. That is, it is not sufficient to simply identify an arbitrary figure which may or may not cover the loss and damage the innocent party may incur as a result of a delay or default.

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