



EFFECT OF LIQUIDATED DAMAGES STATED AS '£NIL' — EXCLUSIVE REMEDY?

This article looks at the effect of liquidated damages being stated as '£nil' as a remedy for breach of contract and whether this operates as an exclusive remedy for breach.

Liquidated damages operate by way of an obligation, which is agreed in advance by the parties, to make certain payments which are triggered by a particular, identified breach of contract. The term 'unliquidated damages' means compensation for a breach of contract which cannot be established in advance because it is unidentifiable or subject to an unforeseen event.

Consider this scenario:

- The parties are finalising a contract based on an industry standard template. That template includes the possibility of liquidated damages being specified as a remedy for delay in completion of the work.
- When filling out the template, the parties insert a rate of '£nil' in the provision for liquidated damages.
- Clearly this means that no liquidated damages are payable for delay.
- But what liability would the parties expect to exist for unliquidated damages, which could otherwise be claimed, if there was a delay? The result may not be as expected.

EXCLUSION OF ALL DAMAGES

In *Temloc v Errill Properties* [1987], the Court of Appeal ("CA") decided that by inserting '£nil' in the JCT Standard Form Template as the amount of liquidated damages payable for delay in relation to a construction project, any liability for liquidated damages was excluded but this had the effect of excluding liability for unliquidated damages for delay as well.

The CA came to this conclusion because as a matter of interpretation in construing the contract as a whole, it considered that the parties had agreed to exclude damages for delay altogether - [the parties' agreement in relation to an entitlement to liquidated damages for delay \(albeit that this was nothing\) replaced the remedy to receive unliquidated damages](#). The CA said there was no need for there to be express wording to bar a claim for unliquidated damages.

We refer to this finding in this article as the '**Temloc principle**'.

The *Temloc* case, although decided based on very specific background facts, has been followed and endorsed on a significant number of occasions.



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FOLLOWING THE TEMLOC PRINCIPLE

In *Chattan Developments v Reigill* [2007], a similar issue arose regarding liquidated damages to the one in the *Temloc* case:

- The parties entered into an oral agreement which incorporated certain terms of the JCT Standard Form construction template. This agreement was evidenced by a letter subsequently sent by the contractor to the employer which included the statement, "*Liquidated and Ascertained Damages - n/a*".
- The arbitrator decided as a fact that the parties had agreed there would be no right to damages at all for late completion, that is to say, either liquidated or unliquidated.
- It was argued that really clear words were required for the parties to exclude a remedy for a breach of contract. However, the Court held that the arbitrator's finding of fact was perfectly reasonable. This followed the House of Lords' decision in *Gilbert-Ash v Modern Engineering* [1974].

The judge in *Chattan* noted that whilst the nature and effect of the relevant clause will depend on its construction, "... *when there is a valid and enforceable liquidated and ascertained damages clause within an agreement, those damages are the sole and exclusive remedy for the particular breach to which they relate. ... Unliquidated damages are not recoverable because the parties' agreement of liquidated damages replaces the remedy which would otherwise be available for breach. ... The question of whether unliquidated damages could be recovered was a matter for the interpretation of the agreement from which it was possible to find a clear intention to exclude that remedy*".

AVOIDING THE TEMLOC PRINCIPLE

Instead of entering '£nil' as the amount into a liquidated damages clause and effectively losing the right to recover unliquidated damages, the possibility of a different outcome was recognised in *Chattan*.

The judge indicated that *if the parties had formally agreed to delete the contractual provisions relating to liquidated damages, then there would still be a right to recover unliquidated damages*.

SERVICE CREDITS FOR POOR PERFORMANCE

Notably both *Temloc* and *Chattan* dealt with liquidated damages for delay. Would a similar approach be taken with the interpretation of service credit clauses for poor performance? After all, service credits are typically expressed as a form of liquidated damages.

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If these two cases are followed, as a matter of construction and in the absence of any wording to the contrary, there must be a distinct possibility that service credits would be treated as the exclusive remedy for a failure to meet relevant service levels even where that is not plainly stated.

There is a clear and evident risk of this leading to unintended consequences. [It is strongly advisable to circumvent any argument by stating expressly whether or not a customer is to have the right to claim general damages in addition to any service credit regime.](#)

Clarity has obvious benefits for customers. However, we would argue that clarity also has advantages for suppliers in helping to establish a consensus and avoid the legal costs and wasted management time in fighting a case which may ultimately prove that *Temloc* is not quite so definitive as seems to have been thought. In our view, it is at least arguable that liquidated damages for delay and service credits for poor performance are different animals.

Delays in completion are perhaps something that parties to a construction contract are more likely to say should not attract a damages payment from the builder. After all, the builder still has to bear the ongoing costs of completing the work.

On the other hand, failure to comply with service levels for performance does not often incur additional ongoing costs for the supplier but does, more directly, impact upon the customer and its business. This difference could help support a claim by an affected customer that the *Temloc* principle should not be applied to a breach of service levels for performance, should such an argument be necessary. However, it would be far preferable not to have to rely upon such an untested and uncertain line of reasoning.

UNREASONABLE UNDER UCTA?

None of the decisions we have seen on this point seem to discuss whether a liquidated damages provision stating '£nil' is payable, which effectively operates as an exclusion of liability, could be challenged as being unreasonable under the Unfair Contract Terms Act 1977 ("**UCTA**"). This may be because the clause was regarded in each case as having been individually negotiated.

However, in appropriate situations, challenging a clause in accordance with the UCTA reasonableness test (or the equivalent common law test which the Courts sometimes apply) might be another useful way for a customer to avoid the unexpected outcome of the *Temloc* principle.

IN SUMMARY

- The *Temloc* case seems to have been referred to quite regularly over the years and has repeatedly been approved by the Courts. However, in our view, it is a decision which is difficult to justify and which should not necessarily be taken as definitive for similar situations in the future.

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- Equally, the *Chattan* decision is not quite as persuasive to the Courts when analysing an issue in another case that some would seem to suggest. In that decision, the arbitrator found as a matter of *fact* that it was more likely than not that it had been agreed as part of the oral contract that there should be no damages whatsoever for delayed completion. It was therefore not strictly necessary to decide as a matter of *law* what the effect of the statement regarding liquidated damages in the subsequent letter was.
- Despite these doubts, [lawyers and others drafting or advising on contracts would be wise to reduce uncertainty and avoid the trap seemingly set by *Temloc* by being explicit about whether the liquidated damages remedy stated is intended to be exclusive or not.](#)

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| | | | |
|-------------------------|--|--------------------|--------------------|
| Paul Golding | p.golding@TRGLaw.com | +44 (0)1483 730303 | +44 (0)7974 351750 |
| Tracey Tarrant | t.tarrant@TRGLaw.com | +44 (0)1273 277429 | +44 (0)7957 366684 |
| Angela Cornelius | a.cornelius@TRGLaw.com | +44 (0)118 9422385 | +44 (0)7710 055249 |

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Registered office: Lyndhurst, Guildford Road, Woking, Surrey GU22 7UT, United Kingdom

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