Study on Liquidated Damages in International Construction Contracts

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Ⅰ. What is Liquidated Damages?

1. Conceptual Basis of Liquidated Damages

Liquidated damages are methods of recovery for the breach of a contract. Frequently, liquidated damages provisions are specified in construction contracts where a specific amount of money is hard to determine because of complicated circumstances. In the absence of liquidated damages provisions in the contract, the owner has to itemize the actual damages and

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present them to the contractor in order to recover. Because the amount is hard to determine, the parties agree to a specified amount of money that must be paid if one of them fails to observe the contract. The purpose of this agreement is to ensure that the failure of one party to follow the contract does not unfairly hurt the other and the amount agreed must be a reasonable estimate of the potential damage a breach of contract might cause. Liquidated damages clauses act as insurance for both parties. The person who breaches the contract knows ahead of time how much they would owe the other party. Similarly, the other party can negotiate an amount that would adequately cover their loss without having to go to court. However, the purpose of a liquidated damages clause is not to punish the person that breaches the contract.

2. The Advantages of Liquidated Damages

Liquidated damages have two principal advantages over general damages in that first they are payable by the contractor without the employer's proof of his actual loss and secondly they are identified at the outset of the contract and therefore the contractor is available throughout the contract period to expect the consequences of any delay in completion or lack of performance of the structure.[1)]

1) Joan Scriven / Nigel Protchard / Jeff Delmon, *A contractual Guide to Major Construction Projects*, Sweer & Maxwell, 1999, 99면.

Ⅱ. Types of Liquidated Damages

In construction contracts, there exist two types of Liquidated Damages in construction contracts.

1. Delay Liquidated Damages (DLD)

Delay Liquidated Damages may be invoked if one party fails to meet the time for completion. If time for completion date is stipulated in the contract, and the contractor fails to meet the deadline, it can constitute Delay Liquidated Damages.

• Example of Delay Liquidated Damages

Liquidated Damages shall be assessed against Contractor for failure to complete the Project portions by the applicable preliminary Acceptance Dates specified an Attachment II. Liquidated Damages shall be calculated for each day of delay based on the "Daily Average Cost (DAC)" of the Project.

DAC equals the project portion contract price, so stated in Schedule "C", which is the total number of days from the Effective Date of the Contract to the project portion Preliminary Acceptance date.

That is

DAC = The total liquidated damages assessed against Contractor for each project portion shall not exceed ten percent (10%) of each Project Portion Contract Price.

2. Performance Liquidated Damages (PLD)

The other is Performance Liquidated Damages which can be caused if the contractor fails to meet the Performance requirement in the contract. It is generally used in Plant Construction rather than in building or civil engineering construction.

In Plant Project, Performance Test is a matter of importance. Generally EPC Turnkey contractor guaranties the Performance Warranty at the time of doing Performance Test. If the contractor fails to meet the minimum standard for the performance warranty, the Company can recover the performance liquidated damages in proportion to the lack of performance.

• Example of PLD in FIDIC Contract

In the Article 12. 4. of FIDIC Yellow book and Silver Book, the Failure to pass Tests after completion is made if the following condition applies, namely.

(A) The Work, or a Section, fail to pass any or all of the Tests after completion.

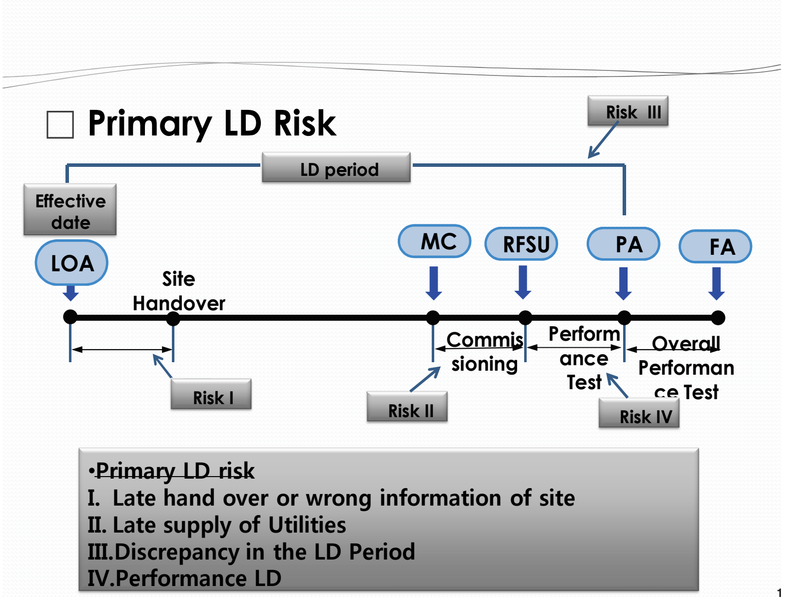
(B) The relevant sum payable as non-performance damages for this failure is stated.

(C) The Contractor pays this relevant sum to the employer during the defects Notification Period.

Generally there is a ‘cap’ for the Performance Liquidated Damages.

But these are not all types of Liquidated Damages. Liquidated damages clauses may be used for non-delay breaches such as Procurement Liquidated damages[2] or Health and Safety Liquidated Damages. Any situation which breaches contract can be stipulated in contract as Liquidated Damages.

3. Primary LD Risk Management



〈Drawing1 : Primary LD risk〉

There are series of possibility which the Liquidated Damages issue would occur throughout the project cycle.

(1) Risk I. Late Hand Over or Wrong Information of Site

Liquidated Damages Period starts from the effective date as indicated

2) If contractor fails to meet the domestic contents rate in procurement, then he may compensate liquidated damages according to proportion stipulated in the contract.

in the Invitation to Bid (ITB). The Effective Date needs to be clearly defined in the Contract in order for the completion date to be identified. Normally the effective date is stated in the contract within 1 month after getting the LOA (Letter of Award).

If the scope of work for site hand over is stipulated in charge of Owner in the contract, the Owner is responsible for that work. But the damages caused from the late handover could be in response of the Contractor. So when drafting the contract the time for site handover should be clarified.

Sometimes, the wrong information with respect to the Site such as soil condition or the bearing power can be a huge causation for the delay. So owner's liability regarding the site information should be specified in the contract.

(2) Risk II. Late Supply of Utilities

Until Mechanical Completion (MC), Owner is responsible for Utility supply for commissioning. Utilities means the materials such as electricity, water, catalyst, steam, cooling water, Nitrogen, etc which is necessary for the plant construction. After the pre-commissioning, the responsibility for the supply lies on the sub-contractor. If utilities are not provided adequately in a timely manner, then Liquidated Damages issue would occur. Therefore, the liability for utility supply should be specified in the contract.

(3) Risk III. Discrepancy between LD Period and Construction Period

If the Project construction period is stipulated in the contract till Ready

For Start Up (RFSU) day and the period for LD is till Provisional Acceptance, then problematic issue would occur because of discrepancy between LD period and Construction Period. The Provisional Acceptance date is supposed to be presented by the Contractor. So at the outset of the contract, the Contractor needs to specify the LD period clearly.

(4) Risk Ⅳ. Performance Liquidated Damages

Performance Liquidated Damages can be applied differently according to each unit installed in the plant. So the Contractor should set a reasonable standard for performance warranty as per each project unit and apply different standard of Performance LD in contract.

Ⅲ. Difference between Liquidated Damages and Penalty Clauses

1. Penalties – General Introduction

Penalties could be interpreted as quantitatively excessive liquidated damages and are invalid under the common law. While liquidated damages are a pre-calculations of estimated loss under the contract, penalties go further and seek to punish a party in some way for breach of contract above and beyond the loss suffered by one party as a result of breach. Many clauses which are found to be penalty clauses are expressed as liquidated damages clauses but are considered by courts as excessive, or punitive and so invalid. So distinction between liquidated damages and penalties does not rely on the name but on the legal characteristics and the intention of both parties at a time of contracting.

2. Case – Iowa Supreme Court, Highway Construction

The Iowa Supreme Court[3] held in 1991 that liquidated damages clauses in three highway contracts were unenforceable penalties. The contractor had entered into three contracts at the same time for highway found that each required completion within 40 days and was called for liquidated of 400 dollars per day. The contractor finished two of the contracts behind the schedule. A contractor withheld money, alleging that the claim of liquidated damages was punitive in nature. The court held that a project owner must be able to show how the daily rate calculated on the total contract price. The county assessed a daily rate of 400 dollars in each case. Further, at the trial, one of the country's engineers testified, "We wanted the liquidated damages amount to be sufficient to make the contractor aware that we need that project completed." In the Court's view, this testimony added to the impression that the liquidated damages assessment was intended as a penalty rather than reflecting the level of damages that conceivably could have been suffered from late completion.[4]

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3) *Rohlin Construction Co., Inc. v. City of Hinton*, 476 N. W.2d 78 (Iowa 1991)

4) Stuart H. Bartholomew, *Construction Contracting: Business and Legal Principles (2nd Edition)*, Prentice Hall, 2001, 255면.

Ⅳ. Comparative Analysis of Judicial Attitude toward LD clauses in International Construction Contracts

1. England and Wales

(1) Genuine pre-estimate of Loss

'The essence of liquidated damages is a genuine covenanted pre-estimate of loss'. So said Dunedin in Dunlop Pneumatic Tyre Company Ltd V. New Garage (1915).[5] What's the meaning of genuine pre-estimate of loss?

1) Genuine Pre-Estimate or Lesser Sum

What is genuine covenanted pre-estimate of loss? Interpretation of Lard Dunedin's definition is little bit complicated. It follows from the Widnes Foundray case[6] that amount stipulated as liquidated damages may be either a genuine pre-estimate of loss or such smaller sums as the parties may agree. It will be no obstacles to liquidated damages that the stipulated sums are patently inadequate as recovery of full loss.[7] More recently in Multiplex

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5) Brian Eggleston, *Liquidated Damages and Extensions of Time: In Construction Contracts (3rd Edition)*, Wiley-Blackwell, 2008, 76면.

6) *Widnes Foundry (1925) Ltd v. Cellulose Acetake Silk Co. Ltd*

7) The House of Lord confirmed the decision of the Court of Appeal on the basis that the stipulated sum was by way of compensation. Lord Atkins made the following pronouncement;
'Except that it is called a penalty, which on the cases is far from conclusive, it appears to be an amount of compensation measured by the period of delay. I agree that it is not a pre-estimate of Actual damage. I think it must have been obvious to both parties that the actual damage would be much more than 20 dollars a week, but it was intended to go toward the damages, and

Constructions Pty Ltd v. Abgarus Pty Ltd (1992) it was said;

"It is clear as a matter of principle, and established by authority, that if parties agree upon a quantum of damage as liquidated damages which are less than the damages which would be suffered from such breach, no attack can be made upon such a liquidated damages provision upon the basis that it is extravagant or unconscionable.

2) Loss Need not be Suffered

Should the loss be proved by the innocent party? The issue came up in the case of BFI.[8] DCB, the contractor, carried out alteration and refurbishment work at BFI's transport depot. BFI were given possession on the extended date for completion but it was another six weeks before roller shutter doors were installed. BFI utilized this time to fit out the premises and did not suffer any delay in commissioning or any loss of revenue. Various disputes went to arbitration and the arbitrator held there was a delay in completion but he declined to award liquidated damages on the grounds that BFI had suffered no loss. The case went to appeal. Judge Davies rejected this argument and accepted that it was irrelevant to consider whether there was any loss, the liquidated damages provisions worked automatically once breach was established.[9]

(2) Is the Employer Required to Demonstrate a Loss in Order to Claim Liquidated Damages? No.

The purpose of a liquidated damages clause in England is to fix the amount

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it was all the sellers were prepared to pay'.

8) *Group of Companies Ltd v. DCB Integration System Ltd* (1987).

9) Brian Eggleston, 앞의 책, 78면.

of damages recoverable, irrespective of the actual loss suffered by the contractor's breach. The rate of damages stated in the contract is the sum recoverable, even if the actual loss suffered by the employer is smaller or greater than actual amount of damages recovered. As mentioned, in BFI case[10] above, it was irrelevant to consider whether there was any loss or not. Liquidated damages provisions worked automatically once breach was established.

(3) How to Distinguish Liquidated Damages Clause from Penalty?

The key point to enforcing a liquidated damages clause is that the rate stated represents a genuine covenanted pre-estimate of loss as mentioned above in the Donlop case.[11] Where the rate stated does not represent a genuine pre-estimate of the loss likely to be suffered, it is a penalty clause aimed at punishing the party in breach, and the courts have held Penalty is impermissible. The difference between a Liquidated Damages clause and a penalty clause is in fact rests ultimately on the parties' intention at the time of contracting.[12]

In the Dunlop case, the Lord Dunedin provided several standards for distinction. He said the clause will be a penalty clause

(A) If the sum stipulated for is extravagant and unconscionable in amount in comparison with the greatest loss that could conceivable be proved to have followed from the breach.'

10) *Group of Companies Ltd v. DCB Integration System Ltd* (1987)

11) *Dunlop Pneumatic Tyre Company Ltd V. New Garage and Motor Co Ltd* (1915) AC79.

12) Jacob C. Jorgensen, *Delay Clauses in International Construction Contracts*, Wolters Kluwer, 2010, 126-127면.

(B) If the breach consists only in not paying a sum of money, and the sum stipulated is a sum greater than the sum which ought to have been paid,

(C) When a single lump sum is made payable by way of compensation, on the occurrence of one or more or all of several events, some of which may occasion serious and others but trifling damage.

The fact the parties have described the clause as a 'liquidated damages clause' or a 'penalty clause' is a relevant factor but is not conclusive.13)

(4) Can the Employer Claim Damages for Delay as an Alternative of in Addition to a Claim for Liquidated Damages? No.

Liquidated Damages are an exhaustive remedy for the breach to which they apply, and the employer will have no option of claiming general damages instead of Liquidated Damages.14)

(5) Under which Circumstances Can the Employer Defeat a Clause Limiting the Contractor's Liability for Delay?

The employer cannot defeat a clause limiting the contractor's liability for delays such as 'ceiling' or 'cap' clause whether limited by way of under-liquidation15) or by inclusion of a ceiling clause, both of which are agreed

13) *Elphinstone v. Monkland Iron and Coal Co*(1886) 11 App Case 332.

14) Jacob C. Jorgensen, 앞의 책, 128면.

15) *Multiplex Constructions Pty Ltd v. Abgarus Pty Ltd* (1992) 33 NSWLR 504, The court said that' an attack on an under-liquidated damages clause by virtue of it not being a genuine pre-estimate of loss must fail. Where the

to by the parties at the outset.

(6) How are Claims for Liquidated Damages calculated and enforced?

In contract there are three essential principles limiting the recovery damages at common law

(A) The loss must have been caused by the injury complained of:

(B) The loss must not be too remote; it must be of a kind or type that was a reasonably foreseeable consequence of the injury; and

(C) The claimant is under a duty to take reasonable steps to mitigate his loss

The contract breaker is liable for the resultant damages that were within his reasonable contemplation. The requisite degree of foresight is set out in the two limbs of the rule in Hadley v. Baxendale[16)]

1) Those damages that may fairly and reasonably be considered as arising naturally, that is, according to the usual course of things from the breach of contract; and

2) Those damages that may reasonably be supposed to have been in the contemplation of both parties at the time they made the contract as the probable result of the breach of it.

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parties agree, a rate of liquidated damages that is less than the amount of loss likely to be suffered from a breach, the clause cannot be attached on the basis that the amount is 'extravagant or unconscionable'.

16) Hadley b. Baxendale (1854) 9 EX 341

(7) Can the Contractor Claim a Reduction of the Employer's Claim for Liquidated Damages? No.

Liquidated damages clause is operative as written in the contract, unless there is valid extension of time or employer's waiver of right.

(8) Under which Circumstances Can the Contractor or the Employer Claim an Extension of an Agreed Time Limit and Who Owns the 'Float'?

The law has developed a principle of known as the 'prevention principle'. This means that where a contractor is prevented from completing by the contractual completion date by the act or omission of the employer,[17] the employer can no longer insist on the completion date.

The consequences of the prevention principle are avoidable if the contract provides an effective mechanism for granting extension of time.

Clear drafting for the extension of time provision is required. For example, in Peak Construction case,[18] the Phrase 'other special circumstances' has been held to be insufficient. Note that this wording is used in the FIDIC form.[19]

A further example of the court's strict interpretation of extension of time clauses is where a retrospective extension of time may need to be awarded after the completion date. Clear drafting is required if the parties intended

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17) *Holme v. Guppey* (1838) 3 M & W 387

18) *Peak Construction (liverpool) Ltd V, Mckinney Foundation Ltd* (1970) 1 BLR 111.

19) FIDIC conditions of contract for construction (1999)

for extension of time to only occur before the completion. The court held that the phase 'to assign such other time or times for completion as to him may seem reasonable' could not envisage that extension should be granted and purported extension made after the completion was invalid.

The 'float'[20] is not generally dealt with in standard form of contracts and parties fail to address it themselves. It seems the courts will deal with the issue on a case by case basis and apply factual circumstances of each case. Since addressing ownership of the float contractually can give the one party a significant advantage over the other in respect to time and costs, the contractor should take a well care of the float clause.

(9) Drafting Recommendation

Liquidated Damages must be the genuine pre-estimate of loss. Otherwise it can be construed as Penalty by court and it's unenforceable.

The contractor will be able to defend a claim for liquidated damages where the rate is held to be penalty. It is not necessary to establish proof of loss to take the benefit from an operative liquidated damages clause. The formula for arriving at a genuine pre-estimate should be agreed at the outset of the project.

Where liquidated damages clause is operative but for the valid extension of time or an employer's waiver of right to claim them, liquidated damages represents to sole remedy. The employer cannot seek to disregard the rate

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20) The float is the time available for an activity in addition to its planned duration. It's a spare time with in a program, which can apply to the overall program or to a particular activity. It allows extra time to perform each task or complete the works, to all0w the contractor to deal with any unforeseen problems.

of liquidated damages.

Where a contractor limits his liability for liquidated damages in the contract that limit will be effective.

2. Malaysia

(1) Is the Employer Required to Demonstrate a Loss in Order to Claim Liquidated Damages?

In this country there is no difference between penalty and liquidated damages. In brief, in Malaysian Law, in every case if a sum is named in a contract as the amount to be paid in case of breach, it is to be treated as penalty.

The rule of the recovery of liquidated damages in Malaysia is somewhat different from the United Kingdom because of the strict interpretation of section 75 of the Contract Act 1950 by the Federal Court in the case of Selvakumar,[21] where it was held that the party claiming liquidated damages needs to prove the actual loss suffered. Unlike the English law, liquidated damages and penalties are both treated in section 75 of the Contracts Act 1950

(2) How to Distinguish Liquidated Damages Clause from Penalty?

In Malaysia, there is no distinction between liquidated damages and penalties in view of Article 75 of the Contracts Acts 1950 which provides that in every case the court must determine what reasonable compensation is.[22]

21) *Selva Kumar a/l Murugiah v. Thiagarajaf a/l Retnasamy* (1995) 1 MLJ 817.

22) Jacob C. Jorgensen, 앞의 책, 205면.

(3) Can the Employer Claim Damages for Delay as an Alternative of in Addition to a Claim for Liquidated Damages?

It appears that liquidated damages clause is not an alternative, but it does not prevent recovering general damages at common law. Therefore, in the situation liquidated damages clause is held to be ineffective, the relevant parties will be entitled to claim for general damages.

(4) Under which Circumstances Can the Employer Defeat a Clause Limiting the Contractor's Liability for Delay?

Liquidated damages would be considered to be within reasonable contemplation of the parties and therefore foreseeable and not too remote. The liquidated damages amount is always regarded as the ceiling amount recoverable and therefore must not exceed the sum fixed. It is unusual for a court to reverse the express intention of parties to a contract, especially in construction matters in which the parties have equal bargaining strength.[23)]

(5) How are Claims for Liquidated Damages Calculated and Enforced?

The following demonstrate the calculation of Liquidated Damages for a government Project

Liquidated damages = Contract Sum x BLR[24)] (10%) / 365 days

23) Jacob C. Jorgensen, 앞의 책, 213면.

24) Vase Lending Rate (BLR) is a minimum interest rate calculated by financial

(6) Can the Contractor Claim a Reduction of the Employer's Claim for Liquidated Damages? Ok

When the contractor fails to finish the work by the completion date but substantial work has already been done, it is a general rule that the liquidated damages be reduced accordingly.

Extension of time and "*contra proferentum*" against the employer[25] can be efficient way of offense.

It is also a general rule that reasonable steps must be taken to mitigate losses following a breach. A party who fails to do so cannot later recover for such losses because of his neglected actions.[26] The damages awarded to the respondent for failing to mitigate were reduced accordingly.[27]

(7) Under which Circumstances Can the Contractor or the Employer Claim an Extension of an Agreed Time Limit and Who Own the Float?

Unless specific provisions are stipulated in the contract, an extension of

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institutions based on a formula that takes into account the institution's cost of funds and other administrative costs. (Jacob C. Jorgensen, 위의 책, 217면)

25) known as "interpretation against the draftsman", is a doctrine of contractual interpretation providing that, where a promise, agreement or term is ambiguous, the preferred meaning should be the one that works against the interests of the party who provided the wording. (Wikipedia)

26) *Kabatasan Timber Extraction Co. v. Chong Fah Sing* (1969) 2 MLJ 6. It was held that it was the duty of the respondent to take reasonable steps to mitigate damages caused by the appellant when he failed to deliver logs to mill. (Jacob C. Jorgensen, 위의 책, 219면)

27) Beatrix Vohrah & Wu Min Aun, the Commercial Law of Malaysia (Singapore Longman, 2008). 179.(Jacob C. Jorgensen, 위의 책, 220면)

an agreed time couldn't be allowed. The phrase such as "circumstances beyond the contractor's control" does not allow for delays for which the employer is responsible.[28)]

(8) Drafting Recommendation

There would be an opinion saying that liquidated damages is not of importance since the burden of proof still remained. But Malaysia is a crucial place for the construction.

In Malaysia, the contractor has always assumed that when there is an occurrence of such a delay caused by the employer, he will automatically be entitled for extension of time. Unfortunately, the programme of works for most projects in Malaysia is usually neither detailed nor realistic. It is usually used for 'show' more than anything else, which is the cause of many incidences in which extension of time was not granted, even when the contractor rightly has its entitlement to extension of time if a proper programme of works was presented. So it is advisable and desirable that all contractors have an understanding and prepare a detailed and realistic programme of works with proper extension linkages of the activities indentifying the critical path.[29)][30)]

Additionally, it shouldn't be overemphasized that liquidated damages set should be a genuine pre-estimated damages amount.

Ideally, the contractor must know exactly what the client's losses are,

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28) Malaysian Precedents & Forms : Engineering and Construction Contracts : Book 1, MLJ 261. (Jacob C. Jorgensen, 위의 책, 221면)

29) Critical Path is the short cut which takes shortest time but this way should incorporate all of the crucial activities in the project.

30) Jacob C. Jorgensen, 위의 책, 225면.

to appreciate the extent for risk demonstrated by the liquidated damages clause and to use it as a mechanism to mitigate the delay.

3. USA

(1) Is the Employer Required to Demonstrate a Loss in Order to Claim Liquidated Damages?

If the liquidated damages bear no relation to the actual damages, the liquidated damages will not enforceable.[31] However, such cases are few and far between, and in the vast majority of cases a liquidated damages provision will be enforced as written.

(2) How to Distinguish Liquidated Damages Clause from Penalty?

Many courts have expanded this standard into a three-part test for assessing the enforceability of liquidated damages provisions.

1) The liquidated damages must be a reasonable estimation of the anticipated or actual damages.
2) The actual damages that would result from the breach must be difficult to prove.
3) the provision must be intended to compensate for damages actually sustained rather than to penalize the breaching party[32]

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31) *Dahlgren Ltd Partnership v. Board of Supervisors*, for example, the Virginia Supreme Court refused to uphold a liquidated damages amounting to 12.5% of the total contract price, stating "the amount is grossly in excess of actual damages".

32) Heckman & Edwards, supra n. 8. (quoting Kyle E. Hart, liquidated Damages,

In the case of Dahlgren Ltd Partnership v. Board of Supervisors, for example, the Virginia Supreme Court refused to uphold a liquidated damages amounting to 12.5% of the total contract price, stating “the amount is grossly in excess of actual damages”

(3) Can the Employer Claim Damages for Delay as an Alternative of in Addition to a Claim for Liquidated Damages?

Generally, an owner cannot be recovered for delay as an alternative or additional claim for liquidated damages as long as the liquidated damages provision in the contract is written adequately to cover all types of potential damages. However, where liquidated damages provisions is written inadequately to cover all types of damages for delay, an owner may have a claim for delay damages in addition to liquidated damages.[33)]

Where a contract calls for both actual damages and liquidated damages, courts will generally uphold both so long as it is certain that the parties intended both types of damages to apply.

(4) Under which Circumstances Can the Employer Defeat a Clause Limiting the Contractor’s Liability for Delay?

The main purpose of a liquidated damages clause is to set the amount of damages to a certain per diem amount. Thus, ‘liquidated damages become both a ceiling as well as a floor for establishing an owner’s recovery for

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in Construction Business handbook, ed. Cushman, 2004, 658면. (Jacob C. Jorgensen, 위의 책, 342면)

33) *Hathaway & Co. v. United Stated* (1919) the United States Supreme Court

delay.[34] In Worthington Corp. case,[35] the court refused to allow the owner to recover the whole damages of 4 million because Liquidated Damages provision was an 'unambiguous liability limitation' and as such, should be enforced as written.

Generally, the only circumstances under which the owner could defeat a clause limiting the contractor's liability for delays would be where the contractor committed fraud or made a material misrepresentation.[36]

(5) Can the Contractor Claim a Reduction of the Employer's Claim for Liquidated Damages?

In majority of delay claims, a liquidated damages clause will be enforced as written. The exception to this rule is where the owner has contributed to the delay of the construction project.

(6) Under which Circumstances Can the Contractor or the Employer Claim an Extension of an Agreed Time Limit?

Courts are reluctant to grant both time extension and additional compensation to contractors who perform additional work without a formal change order.[37] In Earl T. Browder, Inc Case,[38] the court denied recovery

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34) Heckman & Edwards, supra n. 8.

35) Worthington Corp. b. Consolidated Aluminum Corp, the United Stated Court of Appeals for the Fifth Cerfui

36) Jacob C. Jorgensen, 위의 책, 345면.

37) Pursuant to a change order, the contractor is generally entitled to additional compensation and if necessary, additional time to complete the project.

38) *Earl T. Browder, Inc, v. Country Court of Webster Country*, the West Virginia Supreme Court, 102 S.E 2n 425 (W. Va. 1958)

for work performed by the contractor for the owner, because the contractor had no written authority to perform the additional work, even though the work was performed with the knowledge of the owner.[39)]

(7) Drafting Recommendation

Unlike many countries, the USA grants each party variety rage of freedom in negotiating and drafting almost every provision of their contracts including delay clauses. In this regard, employer on US project must carefully contemplate whether to incorporate liquidated damages clauses in the contract

1) Waiver

The owner should make provisions stating that there shall be no implied waiver based on action or inaction on the part of the owner no right of the owner shall be deemed waived unless the waiver is explicit in written and signed by the owner's representative. As a Contractor, it is advisable to insert waiver clauses.

2) Liquidated Damages

The owner should insert a provision stating that the contractor agrees that calculating actual damages for delay would be difficult or impossible that the stated amount of liquidated damages are reasonable estimate of damages suffered by the delay in completion.

3) Change Orders and Claims

Contractor is required to do to preserve its right to a change order or

39) Jacob C. Jorgensen, 위의 책, 350면.

it right to assert a claim, the more likely it is that such rights will be unintentionally lost.[40]

4. United Arab Emirates

(1) Is the Employer Required to Demonstrate a Loss in Order to Claim Liquidated Damages?

Like the most major legal jurisdictions in the World, UAE law respects the principle of Pacta Sunt Servanda – Latin for ‘agreement must be kept’.

There is no requirement in clause 8.7. for the sum stated in the Appendix to Tender to be reasonable or adhere to any criteria. However, UAE Law provides a right for an aggrieved party to make an application to the court or arbitrator under Civil Code Article 390 (2[41]) to;

very such agreement so as to make the compensation equal to the loss, and any agreement to the contrary shall be void.

It can be concluded that under UAE law the employer doesn’t need to demonstrate a loss in order to claim liquidated damages. In the UAE, parties may pre-agree an amount in their contracts as liquidated damages that shall apply. However, and despite such pre-agreement, the courts and arbitral tribunals have the power, to open up what had been pre-agreed and order instead the payment of compensation based on the actual loss suffered.[42]

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40) Jacob C. Jorgensen, 위의 책, 360면.

41) UAE Civil Code Article 390 (1) provides that

(1) The contracting parties may fix the amount of compensation in advance by making a provision therefore in the contract or in a subsequent agreement, subject to the provisions of the Law

42) Jacob C. Jorgensen, 위의 책, 318면.

(2) How to Distinguish Liquidated Damages Clause from Penalty?

For the employer to claim delay damages there must be

1) Failure by the contractor to achieve the time for completion (for a reason for which he is not entitled to an extension of time) and
2) An assessment of the number of days that has elapsed between the time for completion and the date stated in the taking over certificate and
3) A multiplication of the days assessed by the rate stated in the Appendix to Tender and
4) A sum that results that does not exceed the maximum amount of delay damages (if any) stated in the appendix to Tender.

The ability of the court or arbitral tribunal to vary the agreed level of damages also serves as a mechanism to prohibit attempts to 'punish' contractors for late completion. UAE law will intervene whether the amount of compensation pre-agreed is excessive and punitive rather than compensatory.[43)]

In the case 222 of 2005 in the Dubai Court of Appeal, the Court confirmed that the aim of liquidated damages is not to punish the contractor but should be a 'fair representation of damages that might be suffered'. If punitive, the judge or arbitrator has the discretion to reduce the amount of damages payable.

43) Jacob C. Jorgensen, 위의 책, 317면.

(3) Can the Employer Claim Damages for Delay as an Alternative of in Addition to a Claim for Liquidated Damages?

UAE law will respect the agreement of the parties as provided in the FIDIC clause 8.7. stating ‘delay damages shall be the only damages due for the contractor for such default’.

(4) Under which Circumstances Can the Employer Defeat a Clause Limiting the Contractor’s Liability for Delay?

It is customary in the UAE for contractor’s liability for delays to be capped, often at 10% to 20%. Under the Abu Dhabi Government Construction, which is based on FIDIC, delay damages are capped at 20% of the final contract price.[44)]

(5) Can the Contractor Claim a Reduction of the Employer’s Claim for Liquidated Damages?

As stated above, UAE Law provides a right for an aggrieved party to make an application to the court or arbitrator under Civil Code Article 390 (2[45)]) to;

<u>vary such agreement so as to make the compensation equal to the loss, and any agreement to the contrary shall be void.</u>

44) Jacob C. Jorgensen, 위의 책, 321면.

45) UAE Civil Code Article 390 (1) provides that

(1) The contracting parties may fix the amount of compensation in advance by making a provision therefore in the contract or in a subsequent agreement, subject to the provisions of the Law

Therefore the courts and arbitral tribunals have the power, to open up what had been pre-agreed and order instead the payment of compensation based on the actual loss suffered.[46)]

(6) Under which Circumstances Can the Contractor or the Employer Claim an Extension of an Agreed Time Limit?

Under the FIDIC Conditions, the employer is entitled to claim for delay damages only to the extent that the contractor fails to achieve the time for completion for reason for which the contractor is responsible under the contract.[47)]

(7) Drafting Recommendation

Having said that there provisions of the FIDIC Conditions that would benefit from amendment where the parties so desire in order to clarify their contractual responsibilities These include Float, Concurrency, Time Bars, Consequential Losses, Acceleration, Liquidated Damages, Termination

5. Germany

(1) Is the Employer Required to Demonstrate a Loss in Order to Claim Liquidated Damages?

To claim liquidated damages, the employer has to demonstrate and prove

46) Jacob C. Jorgensen, 위의 책, 318면.
47) Jacob C. Jorgensen, 위의 책, 327면.

that damage has occurred, but not as to the amount. Regarding penalties, the employment does not even have to demonstrate concrete damage. He is free to choose whether to claim for penalties or the precise damage occurred.[48)]

In German practice, a provision for 'liquidated damages'[49)] is uncommon and will be agreed on only on rare occasions. So claims concerning liquidated damages or penalties for delay can only be asserted by the employer if provided in the contract.

The BGH ruled that penalties (in standard terms and conditions or standard from clauses) must contain an upper limit and may not exceed 5.0% of the total order value.[50)]

In the case of a conventional provision for liquidated damages - which in German contractual practice is only circumstantial - the respective sum has to correspond with the damage that could be expected according to the ordinary course of things. Consequently, this has to be assessed in the individual case. Thus the use of a clause for liquidated damages or penalties, whether individually negotiated or based on a standard form, allows for employers to avoid the difficult burden of proof concerning damages.[51)]

(2) How to Distinguish Liquidated Damages Clause from Penalty?

German law primarily distinguishes between liquidated damages and

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48) Jacob C. Jorgensen, 위의 책, 156면.

49) A characteristic provision for 'liquidated damages' serves the purpose to compensate for damages without having to give proof in this matter. Furthermore, a clause regulating damages for delay can - in principle - be used by the employer as means to put pressure on the contractor to carry out his work in due time.

50) BGH *NJW* (2003), 1805

51) Jacob C. Jorgensen, 앞의 책, 154면.

penalties, in which not the term used but the purpose is decisive. Liquidated damages mainly serve the purpose of lump-sum compensation. Penalties, on the other hand, are a much more effective instrument to incite the contractor to accelerate works. The FIDIC world is subject to the strict regal requirements of standard business terms under German law. Therefore, many German construction contracts contain penalty clauses because the calculation and the providing of the burden of proof in order to specify damages for delay are difficult. A valid penalty clause requires fulfillment of the following criteria

1) The percentage for penalties per diem may not exceed 0.3% of the total order value
2) The total amount of penalties may not exceed 5.0% of the total order value
3) In the case in which the penalties for violation of interim time limits exceed the total penalties, such a provision is only valid foremost; the observance of these interim time limits is of importance.
4) Provisions for penalties in general terms and conditions in standard form clauses need to be drafted in a no-fault liability form.

(3) Can the Employer Claim Damages for Delay as an Alternative of in Addition to a Claim for Liquidated Damages

Additional Claims for damages can only be asserted in the case in which the delay concerning penalties as well as such claims for additional damages are based on the same circumstance.

Therefore, under German Law, the employer can assert damages for delay in addition to a claim for penalties. For liquidated damages, there has to be agreement to such assertion. However, penalties of liquidated damages of course have to be deducted from the amount of claim for damages. Finally, the total amount of damages (including penalties of liquidated damages) may not exceed the amount of the actual damages caused by the delay.[52)]

(4) Under which Circumstances Can the Employer Defeat a Clause Limiting the Contractor's Liability for Delay?

The employer cannot claim for the invalidity of an exemption clause limiting the contractor's liability but for exceptional cases.

(5) Can the Contractor Claim a Reduction of the Employer's Claim for Liquidated Damages?

In a case where liquidated damages have been stipulated, which is uncommon in practice, the contractor can only object that the amount agreed up in against public policy and that the provision is thus void.[53)]

Regarding penalties, a differentiation is required. Stipulated penalties are either valid or void. Reduction to an adequate amount is not possible.

However, if the provision has been agreed on by individual agreement and if both contracting parties are not merchants who have been registered as such in the commercial register, the following applies. If the contractor considers the penalties disproportionately high, he can bring to court for legal view and reduction by judicial decision pursuant to BGB section 343.

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52) Jacob C. Jorgensen, 위의 책, 159면.

53) BGH *NJW* (1970), 29

(6) Under which circumstances can the contractor or the employer claim an extension of an agreed time limit?

In the case of disruption of the project, the contractor can insist the time for extension. To claim an extended construction time, the contractor must not simply compare the target time schedule with the actual schedule. In fact, the hypothetical construction schedule, that is as if there had no disruption, is to be determined on the basis of target time schedule.[54)]

(7) Drafting Recommendation

1) Liquidated Damages Clause

Clauses referring to liquidated damages should be waived. In contrast to the FIDIC Red book, under German Law, provisions for penalties and liquidated damages have to be drafted in a no-fault liability form. In addition, there must be compliance with the requirements penalty clause that is effective under German law could be formulated as follows

In the event that the date for the completion of the whole work is exceeded, the contractor shall be obliged to pay to the employer a contractual penalty in the amount of 0.3% of the net order total for each work day in default.[55)] The contractual penalty is limited to a total of 5% of the net order total.[56)]

2) Detailed Time Schedule

To avoid disputes between the contracting parties concerning the time,

54) Jacob C. Jorgensen, 앞의 책, 166면.
55) Jacob C. Jorgensen, 위의 책, 178면.
56) Jacob C. Jorgensen, 위의 책, 177면.

detailed time schedule is needed.

〈Drawing 2 : Table for Comparison〉

	England and Wales	Malaysia	USA	UAE	Germany
Duty to Demons. Loss?	N	Y	N	N, but due to Civil Code 390 (2)	Y, but for the amount For P : N
Requirement for LD	Genuine Pre-estimate of loss	Reasonable Compensation	Reasonable forecast of actual D	Fair representation of D	No-fault Liability
Function of LD	Fixed amount of D	LD : Reasonable compensation(same as P)	Estimate of actual D	Pre-agreed Amount	LD : a lump sum compensation P : Fixed amount + Enforcement work
Distinction between LD and P	Dunlop case	No distinction	Three-part test	LD : not to punish	4 criteria
Additional claim for D	No	No unless LD is ineffective	No unless LD is inadequate	No	Yes, but cannot exceed actual loss
Reduction	N	Y if substantial work has been done	N	Y	LD : N P : exceptional Y
Extension of Time	Prevention principle	If stipulated in the contract	If written form oh change order	If employ is responsible	If prove the disruption n the project reasonably

Ⅴ. Conclusion

Liquidated damages are far from being confined to matters solely involving delay. Properly drafted and judiciously employed, liquidated damages provisions are a useful tool for addressing a wide variety of potential breaches. Like most disputes, a dispute over a liquidated damages clause arises as a result of the lack of understanding and misinterpretation of the wording used in the clause as well as the shortage of information. It would be best, if possible, for both the contractor and employer to consult the necessary bodies and to pay attention to any new developments if they are to play their roles properly and effectively. The primary considerations to keep in mind when drafting them is to ensure they are tailored to the breaches being addressed and thorough understanding about the judicial attitude of each Court should be made first. A greater degree of certainty in liquidated damages may only be achieved if there is commitment and cooperation between the parties.

Key Words : **Liquidated Damages, Delay Liquidated Damages, Performance Liquidated Damages, Penalty, Liquidated Damages Clauses**

[국문요약]

국제건설계약에서 손해배상액 예정조항에 대한 연구

김 현 주*

손해배상액 예정이라 함은 채무불이행의 경우 채무자가 지급하여야 할 손해배상액을 당사자 사이의 계약으로 미리 정해 두는 것을 말한다. 손해배상액 예정조항은 특히 국제건설계약에서 많이 사용되는데, 이는 국제건설계약의 경우, 계약위반에 영향을 미치는 상황이 매우 복잡하고, 정확한 손해배상금액을 산정하기 어렵기 때문이다. 손해배상액 예정조항을 미리 정해 놓지 않은 경우, 사업주가 계약자로부터 손해를 보상받기 위해서는 실제로 발생한 손해를 모두 명시하고 증명해야 한다. 따라서 이러한 입증 곤란을 배제하고 다툼을 예방하여 채무불이행에 있어서 손해배상의 법률관계를 간편하게 하고, 채무의 이행을 확보하려는 것이 손해배상액 예정조항의 목적이다.

국제건설계약에서 손해배상액 예정조항은 주로 지연손해배상, 성능손해배상에 대비하기 위해 사용된다. 지연손해배상은 예정된 공사완료일보다 뒤늦게 공사가 완료된 경우 지연된 날짜에 비례하여 손해배상액을 예정해 두는 것이다. 성능손해배상은 주로 플랜트건설계약에서 많이 사용되는데, 플랜트건설계약의 경우 완성된 플랜트가 미리 계약서에 명시된 성능을 만족시키지 못하는 경우에 그 비율에 따라 손해배상액을 예정해 두는 것을 말한다.

각 국가별로 손해배상액 예정조항의 법적 성질과 기능, 위약벌과의

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구별, 법원에 의한 감축가능성 등에 있어서 차이가 있다. 가령 영국이나 미국의 경우 손해배상액 예정조항이 있는 경우 실손해액을 입증할 필요가 없으나, 말레이시아의 경우 위약벌과 손해배상액예정조항 간에 아무런 차이를 두고 있지 않기 때문에 실손해액을 증명해야 한다. 또한 영국이나 미국의 경우 손해배상액예정조항이 있는 경우, 그 금액이 실손해액보다 크다고 할지라도 법원에 의해 감축이 불가능하지만, United Arab Emirates의 경우 법원에 의한 감축이 가능하다.

국제건설계약에 있어서 손해배상액 예정조항은 잠재적인 계약위반에 대비하기 위한 매우 유용한 장치이다. 그렇지만 손해배상액예정과 관련되어 국제건설분쟁이 발생하기도 하는데 이러한 국제건설분쟁의 대부분은 양당사자간 이해 부족, 정보부족, 계약서의 잘못된 해석 등에서 비롯된다. 따라서 국제건설계약의 계약서를 작성하는 과정에서 양당사자가 충분한 협의와 토론을 거쳐 서로의 상황에 대한 명확한 이해를 바탕으로 세밀하게 손해배상액 예정에 대하여 규정하는 것이 필요하다. 또한 국가별로 손해배상액 예정의 법적 성질이 다르기 때문에 국가별 법제도의 차이점에 대하여 미리 충분히 숙지하고, 이러한 이해를 바탕으로 손해배상액 예정조항을 규정할 필요가 있다.

주제어 : 손해배상액 예정, 지연손해배상, 성능손해배상, 위약벌, 손해배상액 예정조항