

Liquidated Damages Clauses – Important Considerations for Businesses

Frequently, when parties are negotiating terms of a contract, it is desirable for one or both to agree a fixed amount or formula, which sets out a right to damages, should one party act in breach of the contract. This is known as liquidated damages and it is particularly prevalent in the construction and engineering sector.

In the event of a dispute, Court proceedings are often the avenue chosen by businesses to determine the general damages owed. This can, however, be costly, time consuming and complex for all concerned. Liquidated damages clauses, therefore, provide for the payment of a stipulated amount of money if the agreement is breached. The provision also limits the other parties' liability in the event of default.

Whilst liquidated damages clauses do offer parties some certainty in the knowledge of what is payable in the event of a dispute, it is all too frequent for a defaulting party to dispute the clause, typically arguing that it amounts to a penalty. In English law, if a clause is found to be a penalty clause, it is unenforceable.

In the recent case of *De Havilland Aircraft of Canada Ltd v SpiceJet Limited* [2021] EWHC 362 (Comm), the Court had to determine various aspects, one of which was whether the Claimant was entitled to payment of the liquidated damages set out in the contractual agreement between the parties.

In this case, De Havilland was a manufacturer of aircraft. The parties had entered into a purchase agreement in September 2017, setting out SpiceJet's order to purchase 25 aircraft from the Claimant. In April 2019, the agreement was varied, with the schedule for delivery of aircrafts numbered 9 to 25 being suspended, leaving the parties to agree amicable revised terms and conditions regarding those aircraft.

SpiceJet had paid for and accepted delivery of aircraft numbers 1 to 5 but, in respect of aircraft numbers 6 to 20, it had failed to make the pre-delivery payments required in the agreement. With aircrafts 6 to 8, SpiceJet had failed to take delivery from De Havilland.

De Havilland served notices of termination for the undelivered aircraft, as well as terminating the agreement. De Havilland also sought recovery of liquidated damages for all of the undelivered aircraft in accordance with the agreement, totalling \$42.95 million.

De Havilland's position was that the variation to the agreement in April 2019 did not suspend Spicejet's obligation to make pre-delivery payments and De Havilland was entitled to terminate the agreement in its entirety, which rendered the liquidated damages payable.

SpiceJet refused to pay the liquidated damages, and De Havilland subsequently commenced proceedings against them, including an application for Summary Judgment to be entered against SpiceJet.

In the hearing before Sir Michael Burton GBE, SpiceJet relied on three defences:

1. It argued that the suspension of the scheduled delivery months had automatically suspended their obligation to make pre-delivery payments and so, in turn, there was no default regarding aircrafts numbers 9 to 20.

2. With regards to aircraft numbers 6 to 8, SpiceJet argued that they had been prevented to comply with the terms of the agreement, because De Havilland had breached its obligations under a letter of agreement to provide assistance in arranging finance for Spicejet to purchase each aircraft.
3. The liquidated damages clause was an unenforceable penalty.

After the hearing, the Commercial Court handed down Judgment by which it rejected each of SpiceJet's three defences.

The Court found that, whilst there was an agreement to vary the scheduled delivery months, there was no agreement for SpiceJet to avoid payment of the invoices for the pre-delivery payments which had already been accrued. SpiceJet's failure to pay the pre-delivery payments for aircraft numbers 9 to 20 had given De Havilland entitlement to terminate the agreement in its entirety.

With regards to SpiceJet's position that De Havilland had failed to provide assistance to it for arranging finance, this did not amount to an obligation for De Havilland to work with SpiceJet to procure finance. The Court took the view that any assistance would be limited, especially as there was no obligation on the part of De Havilland to incur any expense. The Court held that SpiceJet's compliance with the terms of the agreement were not rendered impossible or prevented by an alleged failure by De Havilland to assist SpiceJet's developing finance.

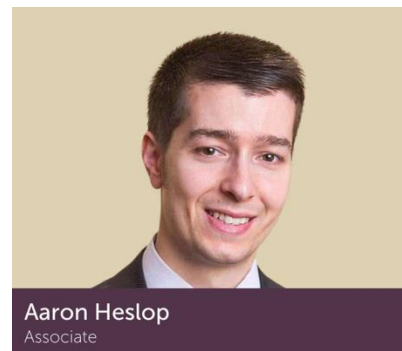
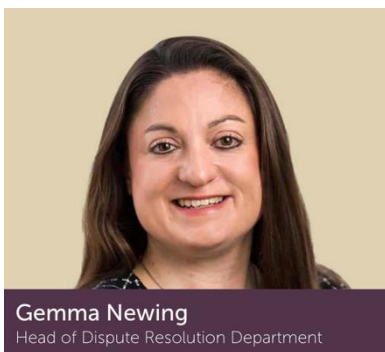
The Court held that De Havilland was entitled to liquidated damages as set out in the agreement.

In reaching this decision, the Court found that the sum per aircraft, calculated and agreed as a pre-estimate of loss, did not amount to an irrecoverable penalty. Both parties were sophisticated commercial operators in the aircraft industry with a long-standing commercial relationship. They were also represented by experienced lawyers. Both clearly had comparable bargaining power with each other. SpiceJet had the opportunity to take advice and use its own experience before entering into the agreement. The liquidated damages clause did not amount to a penalty, with the amount being both agreed and reasonable.

Interestingly here, SpiceJet did not attempt to discredit the realistic nature of the estimate.

This recent case is an important reminder to parties that, while liquidated damages clauses may make you feel as though you are adding more security and predictability to agreements, enforceability of these clauses is not guaranteed. Businesses should therefore carefully consider their position when looking to include a liquidated damages clause in a contract as, in the instance of a breach of agreement, the contracting party may argue that a liquidated damages clause amounts to a penalty and is, therefore, unenforceable.

Seeking professional advice when drawing up contractual agreements is key to ensuring you have the greatest protection for your business needs. Contact [Gemma Newing](#) or a member of the Rooks Rider Solicitors [Dispute Resolution](#) team for advice and assistance.



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