*Nigel Margetson**

A Practical Note on Drafting Exclusion Clauses

Learning From Selected Dutch and English Law and Cases

1. Introduction

A significant risk for any contractor is delay. This is particularly the case in the offshore energy sector, where large offshore installation vessels with their supporting vessels, equipment and subcontractors (referred to as '*marine spreads*') cost many hundreds of thousands of Euros a day. If a marine spread cannot work because of delay of a (sub)contractor (e.g., a contractor who is responsible for supplying required installation equipment to the main contractor / operator of a marine spread), the costs being lost because of downtime of the marine spread will be very large. Such delay can also lead to delay in commencement and completion of projects. In the offshore energy industry that could mean delay in production of first oil or gas or delay in first production from a wind farm.

The financial impact of delay can therefore be huge. If the (sub)contractor causing the delay would be fully liable for such costs, it could go out of business.

Apart from the global limitation of liability clause that every contract should contain, two important contractual clauses that can protect a contractor from excessive liability for delay are:

i. A mutual indemnity clause for consequential loss; and
ii. A clause in which the contractor's liability for delay is limited to a pre-agreed amount of liquidated damages.

These two clauses are very common in contracts in the offshore energy sector. However, it is essential that these two clauses are properly drafted. If they are not, the contractor will be under the illusion that it is protected whereas poor drafting can mean that the contractor is not protected at all.

Below I will first discuss the meaning of consequential loss under Dutch and English law and the drafting of a proper consequential loss clause. After that I will discuss liquidated damages and penalty clauses.

The direct reason for me to write this paper was the English Court of Appeal's decision of 4 April 2022 in the case *Soteria Insurance Limited v IBM*.[1] In that case the court of appeal reversed the judgment of the judge in first instance (O'Farrell, J) regarding the interpretation of a consequential loss exclusion clause. In its judgment, the Court of Appeal, gives a very clear summary of the principles of construction of exclusion clauses under English law whereby it summarises six key judgments. It concludes that the judge in first instance had failed to apply the principles relating to the construction of exclusion clauses contained in *inter alia* those six key judgments.

2. Consequential Loss

2.1. What Type of Damages can be Claimed under Dutch Law?

What damages can be claimed under Dutch law is a matter of causality. The question is whether there is sufficient causal connection between the event and the resulting damages to allow the victim to recover the damages. Under Dutch law, the causality rule is contained in article 6:98 Dutch Civil Code which says:

Voor vergoeding komt slechts in aanmerking schade die in zodanig verband staat met de gebeurtenis waarop de aansprakelijkheid van de schuldenaar berust, dat zij hem, mede gezien de ***aard van de aansprakelijkheid en van de schade****, als een gevolg van deze gebeurtenis kan worden toegerekend.*

Or in English:

Only damages connected in such a way to the event that made the debtor liable, which considering the ***nature of the liability and of the damages****, can be attributed to him as a consequence of this event, are recoverable.*

* DOI 10.7590/187714622X16637684402645 1877-1467 2022 European Journal of Commercial Contract Law
Nigel Margetson, LLM is a partner with MMRL Lawyers in Rotterdam. This article is based on his speaking notes which he used at the conference for contractors in the offshore energy sector organised by MMRL lawyers and Intramar insurance brokers at hotel Thon in Rotterdam on 10 May 2022. The purpose of the conference was to give participants pragmatic advice for drafting effective liquidated damages and consequential loss exclusion clauses.

1. Court of Appeal (Civil Division), 4 April 2022, [2022] EWCA Civ 440.

In each individual case, different factors will be more or less important when deciding which damages can be attributed to an event. Factors are:[2]

(i) the nature of the liability:

a. fault-based liability vs non- fault-based liability: fault-based liability will lead to an earlier attribution of damages than non-fault-based liability.
b. contractual liability vs non-contractual liability;
c. liability for human acts vs liability for damages caused by animals or property.
d. the type of rule that has been breached (e.g. safety rules or traffic rules)

(ii) nature of the damages

a. damages resulting from personal injury or death will sooner be attributed to an event than damages resulting from property damage;
b. damages resulting from damage to property will be attributed to an event before damages due to financial loss;
c. losses will be attributed to an event before loss of profit.

(iii) foreseeability

Are the damages resulting from the event the reasonably foreseeable result of the event? Under the old Dutch law (before 1992) foreseeability was the only factor used when assessing whether there is sufficient causal connection between the event and the damages.[3] Under the current law, foreseeability is one of the various factors considered.[4]

(iv) The nature of the act

Gross negligence will lead to an earlier attribution of damages than an act with a lower degree of negligence.[5]

(v) other factors

In certain circumstances, other factors may also be relevant, e.g. damages caused in a private capacity as opposed to damages caused in a professional capacity.
Cleary, what damages can be recovered under Dutch is dependent on many factors and must be decided on a case-by-case basis.

2.2. *What Losses Are Consequential Losses Under Dutch Law?*

Under Dutch law there is no definition of the terms 'consequential loss' (in Dutch: '*gevolgschade*'), 'indirect loss' (which is sometimes used as a synonym for consequential loss) and 'direct loss'.

Some are of the opinion that the difference between direct damages and consequential loss is the same as the difference between physical damage and pure financial loss.

Another point of view is that direct damage is damage to an object itself and that consequential loss or indirect loss is loss caused by the damage to the object.[6]

There are many theories, but one thing is clear: there is no generally accepted definition of consequential or indirect loss (in Dutch '*gevolgschade*') under Dutch law.[7] This lack of clarity about the meaning of consequential loss can be illustrated by the following case.

ASR v MBS, District court of Utrecht, 12 May 2010[8]

A contractor, MBS, entered into a contract with an individual insured with the insurance company ASR, to waterproof pipes and a cellar. The contract between MBS and its client included the following clauses:

7.4. 4 MBS is nimmer aansprakelijk voor gevolgschade en indirecte bedrijfsschade, stagnatieschade, vertraging van de bouw, verlies van orders, winstderving, bewerkingskosten e.d.

Or, in English

7.4. MBS shall never be liable for consequential loss, indirect loss of production, down time, delay in construction, loss of contract, loss of profit, etc.

and

Warranty: we guarantee that the cellar will be watertight for ten years.

After completion of work, there was water damage in the cellar because one of the pipes had not been made properly watertight. ASR indemnified its insured under the insurance policy, was subrogated in the rights of its assured and sued MBS to recover the damages that its insured had suffered.

ASR claimed an amount of 6,372.52 euros for repairing the damage done to the cellar, cleaning work and replacing the damaged carpet and doors.

MBS invoked clause 7.4. and said that it was not liable for the damages being claimed as those damages were consequential loss. It argued that consequential loss was loss caused as a consequence of the defective waterproofing work.

2. Prof SD Lindenbergh, *Burgerlijk Wetboek Tekst & Commentaar*, 14th impression, commentary at art 6:98 BW.
3. G Snijders, Procureur-Generaal at the Supreme Court of the Netherlands, at para 3.8. of his advice dated 18 March 2022 in the case *Stichting verzekeringsbureau Voertuigcriminaliteit v [defendant]*, ECLI:NL:PHR:2022:246.
4. Prof SD Lindenbergh, '*Burgerlijk Wetboek Tekst & Commentaar*', 14th impression, commentary at art 6:98 BW. However, in cases other than personnel injury cases or cases in which a traffic or safety rule has been breached, foreseeability is still the main rule. See G Snijders, Procureur-Generaal at the Supreme Court of the Netherlands, at para 3.8. of his advice dated 18 March 2022 in the case *Stichting verzekeringsbureau Voertuigcriminaliteit v [defendant]*, ECLI:NL:PHR:2022:246.
5. Prof SD Lindenbergh, '*Burgerlijk Wetboek Tekst & Commentaar*', 14th edition, commentary at art 6:98 BW.
6. TFE Tjong Tjin Tai's 'Directe schade in het contractenrecht', (2007) 11 MvV, 226-231.
7. T.F.E. Tjong Tjin Tai's 'Directe schade in het contractenrecht', (2007) 11 MvV 226-231.
8. ECLI:NL:RBUTR:2010:BM4250.

The court said:

In clause 7.4. of the general conditions the term 'consequential loss' has not been defined. Case law and legal handbooks also do not give a fixed meaning for consequential loss. Article 7.4. does list various types of damage for which liability is excluded, i.e. 'indirect loss of production, down time, delay in construction, loss of contract, loss of profit, etc'. These are all damages that are not an ***immediate*** *consequence of the defective work. The list justifies the understanding that also 'consequential loss' relates to damages that are not the immediate consequence of the defective work. The damages being claimed by ASR, i.e. the repair of the cellar and replacement of damaged carpets and doors all relate to water damage in the cellar, which is the immediate consequence of the defective work. A reasonable interpretation of clause 7.4. of the general conditions means that the damages being claimed by ASR are not 'consequential loss' [emphasis added by author]*

The contractor probably thought that with clause 7.4. it had limited its liability for defective works to the obligation to repair the defective works. This would not be an unusual limitation of liability. However, because the contractor did not make clear enough what it meant by consequential loss, its limitation of liability failed and it was held liable for considerably more costs than merely the costs of repairing the defective waterproofing work.

This makes clear that under Dutch law, relying on generic terms such as '*gevolgschade*' (consequential loss) and similar generic terms will often not suffice to protect a user of an exclusion clause from liability for consequential loss.

2.3. Consequential Loss under English Law

Under English law consequential damages are losses that do not follow directly and immediately from an injurious act but that result indirectly from the act. They are also termed indirect damages.[9]

According to Julian Bailey,[10] 'a consequential loss is a loss that is suffered as an indirect consequence of a breach of obligation. It is not a direct loss. At common law, a party to a contract is entitled, subject to the rules concerning remoteness, to recover as damages and consequential loss suffered as a result of the other party's breach of contract'.

The leading case regarding consequential loss under English law is *Hadley v Baxendale*.[11] Hadley owned a mill with a broken crankshaft. He asked Baxendale to transport the crank shaft to a location where it could be repaired and deliver it back. Baxendale made a mistake and returned the crankshaft a week later than agreed. Hadley claimed damages for loss of profit resulting from the week longer closure of the mill.

Baxendale argued that he was not liable for the loss of profit as he had not known that the delay in return of the crankshaft would cause the mill to be closed. He said that Hadley's loss of profit was too remote to claim.

The court decided in Baxendale's favour saying that a party could only successfully claim for losses stemming from breach of contract where the loss is reasonably viewed to

i. have resulted naturally from the breach, or
ii. where the fact such losses would result from breach ought reasonably have been contemplated of by the parties when the contract was formed.

As Baxendale had not reasonably foreseen the consequences of delay and Hadley had not informed him of them, he was not liable for the mill's lost profits.

Under English law, the first category of damages is deemed to be direct losses and the second category is deemed to be indirect or consequential losses.

Therefore, under English law it is clear what the difference is between indirect or consequential losses and direct losses. However, what would be deemed to be consequential loss in a specific case will often remain a difficult question to answer.

2.4. Some Comments about Proper Drafting of Clauses Excluding Consequential Loss

Both under English and under Dutch law, in a given case, what losses are consequential losses will not always be clear. It is therefore wise for parties not to rely on generic and broad wordings but to properly define what consequential loss means (i.e liability for which they will wish to exclude) and/or to properly stipulate which type of losses they do not wish to be liable for. For example, if a contractor does not want to be liable for stand-by costs of a marine spread, it should define consequential losses (or, in more modern drafting, 'Excluded Losses') as including standby costs of marine vessels and equipment.

Particularly when drafting an exclusion clause for consequential loss under English law it is essential that **clear, specific and precise wording** is used. The following two cases illustrate this statement:

9. Black's Law Dictionary, 11th Edition.
10. Julian Bailey, '*Construction Law*', third edition, section 13.39.
11. *Hadley & Anor v Baxendale & Ors*, Courts of the Exchequer, 23 February 1854, [1854] EWHC Exch J70 (1854) 9 Ex Ch 341; 156 ER 145.

Ferryways NV and Associated British Ports, High Court of Justice, 14 February 2008[12]

In this case, a ship's officer was killed when he was hit by a tugmaster vehicle during unloading of the vessel. Sums were paid by the claimant in respect of his death and for repatriating of his body. The claimant wished to claim these costs from the defendant. The defendant invoked a clause 9 c) to reject liability. That clause 9 c) said:

[…] the Company […] shall have no liability to the Customer […] for any loss, damage, costs or expenses of any nature whatsoever […] ***which is of an indirect or consequential nature including without limitation the following*** *i) loss or deferment of profit; ii) loss or deferment of revenue; iii) loss of goodwill; iv) loss of business; v) loss or deferment of production or increased costs of production; vi) the liabilities of the Customer to any other party.*

The question was if this clause protected the defendant from the claims for sums paid in respect of the death of the ship's officer and the costs of repatriating his body. The court said [paras 84 and 85]:

84. The important question therefore is whether the words in clause 9 'including without the limitation the following' indicate clearly that the parties were giving their own definition of indirect or consequential losses so as to include the specified losses even if they are the direct and natural result of the breach in question. ***In my judgment those words do not provide the sort of clear indication which is necessary for the Defendant's argument. The parties are merely identifying the type of losses (without limitation) which can fall within the exemption clause so long as the losses meet the prior requirement that they 'of an indirect or consequential nature.' Had the parties intended that liability for losses which were the direct and natural result of the breach could be excluded they would have hardly have described such losses as 'indirect or consequential'****.*

85. The losses which are claimed in this case, liability for the death benefit and repatriation expenses, are losses ***which are the direct and natural result*** *of the Defendant's (assumed) breach of contract which caused the death of the Claimant's employee. […] I therefore hold that liability for those losses has not been excluded by the terms of [clause 9c]' [emphasis added by author]*

This is therefore an example of bad drafting. Note that a clause similar to clause 9 c) in the *Ferryways v Associated British Ports* case was contained in the Bimco Supplytime[13] 2005 as clause 14.c.. That clause said:

Neither party shall be liable to the other for any consequential damages whatsoever arising out of or in connection with the performance or non-performance of this Charter Party, and each party shall protect, defend and indemnify the other from an against all such claims from any member of its Group as defined in Clause 14(a). 'Consequential damages' shall include, but not be limited to, loss of use, loss of profits, shut in or loss of production and costs of insurance, whether or not foreseeable at the date of this Charter Party.

Therefore, parties contracting under that charter party who did not change the definition of consequential loss in the standard wording of clause 14 c) were under the impression that they were protected against all claims for loss of profit, loss of production, etc. However, they were only protected against claims for consequential loss of profit, loss of production, etc. In the Bimco Supplytime 2017 contract this mistake in the Supplytime contract was corrected and a proper definition of 'Excluded Losses' was introduced. See clause 14.b. of the Supplytime 2017, which says:

Excluded losses – Notwithstanding anything else contained in this Charter Party neither party shall be liable to the other for:

i. *any loss of use (including, without limitation, loss of use or the cost of use of property, equipment, materials and services including without limitation, those provided by contractors or subcontractors of any tier or by third parties), loss of profits or anticipated profits; loss of product; loss of business; business interruption; loss of or deferral of drilling rights; loss, restriction or forfeiture of licences, concession or field interest; loss of revenue, shut in, loss of production, deferral of production, increased cost of working; cost of insurance; or any other similar losses whether direct or indirect; and*
ii. *any consequential or indirect loss whatsoever; arising out of or in connection with the performance or non-performance of this Charter Party even if such loss is caused wholly or partially by the act, neglect, breach of duty (whether statutory or otherwise) or default of the indemnified party, and even if such loss is caused wholly or partially by the unseaworthiness of any vessel, and the Owners shall indemnify, protect, defend and hold harmless the Charterers' Group from such losses suffered by the Owners' Group and the Charterers shall indemnify, protect, defend and hold harmless the Owners' Group from such losses suffered by the Charterers' Group.*

Note that in the Supplytime 2017, the term 'Excluded Losses' was introduced. That term has been defined as meaning consequential loss under English law (i.e a term that has a clear meaning in law) and a list of other losses (direct or indirect) for which liability is also excluded.

Soteria Insurance Limited (formerly CIS General Insurance) v IBM is another case in which the consequential loss clause did not protect the party that wished to rely on it is :

12. High Court of Justice, Queens's Bench Division Commercial Court, 14 February 2008, [2008] EWHC 225 (Comm).
13. The Bimco Supplytime charter party is a very commonly used charter party in the offshore energy sector. There are various revisions of this Charter Party, e.g. Supplytime 89, Supplytime 2005 and Supplytime 2017, which is the latest version of the contract.

Court of Appeal - Soteria Insurance Limited (formerly CIS General Insurance) v IBM, 4 April 2022[14]

In this case, CIS General Insurance had contracted IBM to deliver an IT system. The project went badly wrong. Eventually, IBM terminated its contract with CIS General for allegedly not paying an invoice on time. CIS General said that it was contractually entitled to withhold payment of the IBM invoice and that IBM had repudiated the contract by unlawful terminating it. CIS General claimed damages consisting of **wasted expenditure** in the amount of approximately GBP 96 million. This wasted expenditure consisted of the amount that CIS General had paid to IBM for the IT system, which IT system IBM had failed to deliver.

The contract between IBM and CIS General contained the following clause 23.3.:

*[…] neither party shall be liable […] for any […] which are indirect or consequential Losses, **or for loss of profit, revenue, savings** (including anticipated savings), data (save as set out in clause 24.4(d)), goodwill , reputation (in all cases whether direct or indirect) even if such Losses were foreseeable and notwithstanding that a party had been advised of the possibility that such Losses were in the contemplation of the other party or any third party'. [emphasis added by author]*

The judge in the court of first instance (O' Farrell, J) held that CIS General's claim for loss of expenditure was excluded by this clause. She said:

682. The loss of the bargain suffered by CISGIL as a result of IBM's repudiatory breach comprised the savings, revenues and profits that would have been achieved had the IT solution been successfully implemented.
683. A conventional claim for damages in this type of commercial case would usually be quantified based on those lost savings, revenues and profits. CISGIL is entitled to frame its claim as one for wasted expenditure but that simply represents a different method of quantifying the loss of the bargain; it does not change the characteristics of the losses for which compensation is sought.
684. Clause 23.3 of the MSA excludes any claim by either party for 'loss of profit, revenue, savings (including anticipated savings) … (in all cases whether direct or indirect) … '
685. In accordance with the above analysis, such a claim is excluded, whether it is quantified as the value of the lost profit, revenue and savings, or as wasted expenditure.
686. It follows that CISGIL's claim for wasted expenditure is excluded by clause 23.3.

CIS General appealed against this decision. The court of appeal allowed the appeal.

In paragraphs 30 – 33 the Court of Appeal first summarised the rules of interpretation that should be applied when reading clause 23.3. First, the Court of Appeal discussed the general rules of construction with reference to the following parts of the following three English Supreme Court cases.

Rainy Sky SA v Kookmin Bank [2011] UKSC 50 at [14]-[30]
…The ultimate aim of interpreting a provision in a contract, especially a commercial contract, is to determine what the parties meant by the language used, which involves ascertaining what a reasonable person would have understood the parties to have meant.

And

…The exercise of construction is essentially one unitary exercise in which the court must consider the language used and ascertain what a reasonable person, that is a person who has all the background knowledge which would reasonably be available to the parties in the situation in which they were at the time of the contract, would have understood the parties to have meant. In doing so, the court must have regard to all the relevant surrounding circumstances. If there are two possible constructions, the court is entitled to prefer the construction which is consistent with business common sense and to reject the other…where the parties have used unambiguous language, the court must apply it.

Arnold v Britton [2015] UKSC 36 at [14]-[22];
15. When interpreting a written contract, the court is concerned to identify the intention of the parties by reference to "what a reasonable person having all the background knowledge which would have been available to the parties would have understood them to be using the language in the contract to mean", to quote Lord Hoffmann in Chartbrook Ltd v Persimmon Homes Ltd [2009] UKHL 38, [2009] 1 AC 1101, para 14. And it does so by focussing on the meaning of the relevant words, in this case clause 3(2) of each of the 25 leases, in their documentary, factual and commercial context. That meaning has to be assessed in the light of (i) the natural and ordinary meaning of the clause, (ii) any other relevant provisions of the lease, (iii) the overall purpose of the clause and the lease, (iv) the facts and circumstances known or assumed by the parties at the time that the document was executed, and (v) commercial common sense, but (vi) disregarding subjective evidence of any party's intentions. In this connection, see Prenn at pp 1384-1386 and Reardon Smith Line Ltd v Yngvar Hansen-Tangen (trading as HE Hansen-Tangen) [1976] 1 WLR 989, 995-997 per Lord Wilberforce, Bank of Credit and Commerce International SA (in liquidation) v Ali [2002] 1 AC 251, para 8, per Lord Bingham, and the survey of more recent authorities in Rainy Sky, per Lord Clarke at paras 21-30.

Wood v Capita Insurance Services Limited [2017] UKSC 24 at [8]-[15]
…In striking a balance between the indications given by the language and the implications of the competing constructions the court must consider the quality of drafting of the clause…

14. Court of Appeal (Civil Division), 4 April 2022, [2022] EWCA Civ 440.

The court of appeal then went on to discuss cases specifically relating to the abandoning of legal remedies. It cited the following parts of the following cases:

Gilbert-Ash (Northern) Limited v Modern Engineering (Bristol) Limited [1974] AC 689, Lord Diplock said at 717H:
one starts with the presumption that neither party intends to abandon any remedies for its breach arising by operation of law, and clear express words must be used in order to rebut the presumption.

Stocznia Gdynia SA v Gearbulk Holdings Limited [2010] QB 27
The court is unlikely to be satisfied that a party to a contract has abandoned valuable rights arising by operation of law unless the terms of the contract make it sufficiently clear that that was intended. The more valuable the right the clearer the language will need to be.

Kudos Catering (UK) v Manchester Central Convention Complex Limited [2013] EWCA Civ 38
29. The parties could had they so wished have provided that there should be an exclusion of all liability for financial loss in favour of the Company, but not the Contractor, in the event of a refusal to perform. That would be a bargain which Mr Phillips has, I suggest, come close to acknowledging is unlikely, not just for the reason given in the last paragraph but also because of his insistence that whilst the Company accepted no liability for loss of profits, the Contractor could enforce the contract against it and thereby earn those profits. ***Had the parties intended such an exclusion of all liability for financial loss in the event of refusal or inability of the Company to perform, I would have expected them to spell that out clearly, probably in a free-standing clause rather than in a sub-clause designed in part to qualify an express and limited indemnity, and in one which moreover forms part of a series of sub-clauses dealing with the provision of indemnities and the insurance to support them.*** *It is plain that the parties intended that this wide category of loss – goodwill, business, revenue, profits, wasted expenditure – should not be recoverable in respect of breaches of the sort itemised by the Respondent in paragraph 47 of its skeleton argument – the inadvertent provision of wrong information concerning events or likely attendance size, the inadvertent exclusion of the Appellant from the catering area or areas ancillary thereto by blocking off, the failure to set out the necessary furniture as required by Clause 19.11 and so on and so forth. In my judgment however by their language and the context in which they used it they demonstrated that the exclusion related to defective performance of the Agreement, not to a refusal or to a disabling inability to perform it.' [emphasis added by the Court of Appeal]*

Applying these principles to clause 23.3., Lord Justice Coulson (with whom the other judges agreed) said:

The short point is whether, as a matter of language, the description of the types of losses being excluded, namely 'loss of profit, revenue, savings' is apt to cover or include 'wasted expenditure'. In my view, the fundamental difficulty, which IBM never addressed, let alone surmounted, is ***that claims for 'wasted expenditure' were not excluded by the terms of clause 23.3 because those words are simply not there.***
I consider that the objective meaning of clause 23.3, as understood by a reasonable person in the position of these parties, was that the clause did not exclude a claim for expenditure incurred, but wasted because of the other party's repudiatory breach. Claims for wasted expenditure – costs actually incurred but wasted – were not referred to in clause 23.3 and, on the natural and ordinary meaning of the words, were not included in 'loss of profit, revenue [or] savings'*. The principles of construction, identified in paragraphs 30 - 33 above, lead inexorably to that conclusion. [emphasis added by author]*

So, the court placed great emphasis on the natural and ordinary meaning of the words.
The court also said [at par. 60]:

The more valuable the right, the clearer the language of any exclusion clause will need to be; the more extreme the consequences, the more stringent the court must be before construing the clause in a way which allows the contract-breaker to avoid liability for what may be his catastrophic non-performance.

It is very clear that under English, when drafting exclusion clauses, broad language, relying on general terms, will not suffice. One has to be very specific: write down precisely what you mean. For example, if you do not want to be liable for any loss of production of hydrocarbons from a well, write that down. Do not merely say that liability for 'loss of production' is excluded. Or, if you do not wish to be liable for costs of other contractors or vessels that cannot work if you are delayed, say that in so many words and do not rely on the generic term 'loss of use'. To increase the chance of validity of exclusion clauses under Dutch law,[15] it would be very wise for the contract drafter to also apply the English drafting rules that we have discussed above to the drafting of contracts under Dutch law.

3. Liquidated Damages and Penalties

Drafting valid liquidated damages clauses that effectively limit a contractor's liability for delay presents its own challenges. In particular, one must be careful to ensure that it is clear that a liquidated damages clause is not in fact a penalty clause.

3.1. What is a Penalty?

A penalty is a pre-agreed amount of money that the breaching party will be liable to pay over and above the amount that it is liable for in damages.

15. Regarding the validity of exclusion clauses under Dutch law see e.g. Prof THM van Wechem's articles 'Leren exonereren: een aantal gezichtspunten ten aanzien van het contractueel reguleren van aansprakelijkheid' (2019) 3 Contracteren 89–99 and 'Leren exonereren: een update' (2021) 3 Contracteren 85–89.

Under Dutch law, and under the law of many other civil law jurisdictions, penalty clauses are valid.
In the Netherlands, penalty clauses are regulated in art. 6:91 Dutch Civil Code:

Als boetebeding wordt aangemerkt ieder beding waarbij is bepaald dat de schuldenaar, indien hij in de nakoming van zijn verbintenis tekortschiet, gehouden is een geldsom of een andere prestatie te voldoen, ongeacht of zulks strekt tot vergoeding van schade of enkel tot aansporing om tot nakoming over te gaan.

Or, in English

A penalty clause is every clause stating that the debtor, when failing to perform his obligation correctly, is obliged to pay a sum of money or deliver another performance, regardless whether this is meant as compensation for damages or just as an incentive to perform the obligation.'

Under English law, penalty clauses are deemed to be contrary to public policy and are invalid.

In the English Supreme Court case *Cavendish Square Holding B.V. v El Makdessi* and *ParkingEye Ltd v Beavis (2015),*[16] the Supreme Court discussed how to assess whether a clause was a penalty clause or not. Lionel Persey QC (sitting as a Judge in the High court case ZCCM Investments Holdings PLC and Kkonkola Copper Mines PLC, 14 December 2017[17]) summarised the Supreme Court's findings in the Cavendish Square case as follows:

- *'…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…', per Lords Neuberger and Sumption at [32];*
- *'…What is necessary in each case is to consider, first,* ***whether any (and if so what) legitimate business interest is served and protected by the clause****, and, second, whether, assuming such an interest to exist, the provision made for the interest* ***is nevertheless in the circumstances extravagant, exorbitant or unconscionable*** *…', per Lord Mance at [152];*
- *'…I therefore conclude that the correct test for a penalty* ***is whether the sum or remedy stipulated as a consequence of a breach of contract is exorbitant or unconscionable*** *when regard is had to the innocent party's interest in the performance of the contract…', per Lord Hodge at [293].' [emphasis added by author]*

3.2. What are Liquidated Damages?
Liquidated damages are not penalties. They are intended to be a limitation of the contractor's liability for delay. In a liquidated damages clause parties agree that in the event of delay the contractor shall be liable for a certain pre-agreed sum of money per day or week of delay, up to a certain pre-agreed maximum amount.

3.3. Drafting of Liquidated Damages Clauses
It is important to draft liquidated damages clauses properly, to make clear beyond doubt that:

i. the liquidated damages are not penalties that can be claimed over and above delay damages; and
ii. the liquidated damages actually limit the liability of the contractor for delay to the pre-agreed amount of liquidated damages.

A properly drafted liquidated damages clause will contain the following elements:

1. If the Contractor fails to complete the Works on or before the Completion Date, the Contractor shall be liable to the Company for Liquidated Damages. The amounts of such Liquidated Damages shall be x% of the Contract Price for every week of delay or pro-rata for part of a week until a *total maximum amount* of y% of the Contract Price. Parties agree that these liquidated damages are a genuine pre-estimate of damages and not a penalty.

2. Payment of such Liquidated Damages shall be the *sole and exclusive financial remedy*of the Company in the event of Contractor's failure to complete the Work on or before the Completion Date.

3. Payment of Liquidated Damages *shall not relieve the Contractor of its obligation to complete the Works.*

4. The Company shall only be entitled to *terminate the Contract* for delay after the maximum amount of liquidated damages has been reached.

If the clause does not contain clauses similar to subclauses 1. and 2.:

i. *Under Dutch law, the liquidated damages may be seen as a penalty that the Contractor becomes liable for, over and above its liability for delay damages; and*
ii. *Under English law, the wording of the exclusion clause may not be clear enough to prevent the Contractor's contractual counterpart from exercising its remedies to claim delay damages at law.*

Sub-clause 3. is intended to assist the contractor in its negotiations with the employer. It gives the employer some comfort to have it written black on white in the contract that reaching the maximum amount of liquidated damages does not release the contractor from its obligation to complete the works.

Sub-clause 4. is meant to protect contractor from termination of the contract as soon as any delay occurs. the

16. Supreme Court, 21, 22, 23 July; 4 November 2015 [2015] UKSC 67.
17. High Court of Justice, Queen's Bench Division Commercial Court, 14 December 2017, [2017] EWHC 3288 (Comm).

period required to reach the maximum amount of liquidated damages for delay is a period in which the employer does not have the remedy of termination for delay.

4. Conclusion

In conclusion parties should not rely on generic and broad wordings. They should not believe that the mere fact that the contract says that liability for 'consequential loss' is excluded or that 'n the event of delay liquidated damages apply' means the consequential loss and liquidated damages clauses are effective exclusion clauses. Parties should be alert to the problems discussed in this paper and apply the principles set out in this paper.