

BRIEFING NOTE

Liquidated Damages in Singapore – Enforceable or Not?

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Introduction

Liquidated damages (“LDs”) are common in commercial contracts. Yet, there are often issues about the enforceability of LD clauses. In this briefing note, we discuss the position on LDs in Singapore. Particularly, the circumstances where LDs are enforceable and unenforceable (for being ‘penalty’ clauses).

Overview of LD Clauses as ‘Penalty’ Clauses

LD clauses are unenforceable if they constitute ‘penalty’ clauses. The question then is, when are LD clauses penal?

The leading statement of principles was laid down by Lord Dunedin in the House of Lords in *Dunlop Pneumatic Tyre Company, Limited v New Garage and Motor Company, Limited* [1915] AC 79 (“*Dunlop*”). There are four principles to determine whether or not a LD clause is penal:

- the clause is penal if the stipulated sum is extravagant and unconscionable compared with the greatest conceivable loss that could flow from the breach;
- the clause is penal if the breach relates only to the non-payment of money and the clause provides for the payment of a larger sum;
- there is a rebuttable presumption that the clause is penal if the stipulated sum is payable on a number of events of varying gravity; and
- the clause would not be penal simply because it was impossible to come to a precise pre-estimation of the true loss.

Subsequently, the UK Supreme Court broadened the *Dunlop* test. In *Cavendish Square Holding BV v Makdessi* [2016] AC 1172 (“*Cavendish*”), it was determined that whether or not a LD clause amounts to a ‘penalty’ clause depends on whether it was out of proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation.

Determining the Enforceability of LD Clauses in Singapore

In *Denka Advantech Pte Ltd v Seraya Energy Ltd* [2020] SGCA 119 (“*Denka*”), the Singapore Court of Appeal considered the decisions in *Dunlop* and *Cavendish*.

In determining whether a LD clause amounts to a 'penalty' clause, the position in Singapore is to apply the *Dunlop* test. The *Cavendish* approach was declined because whether or not the LD clause has a penal effect depends on whether it is a genuine pre-estimate of the loss. If the LD clause is more than a genuine pre-estimate, then the presence of a legitimate (or commercial) interest does not change the fact that the LD clause operates as a 'penalty'.

Further, the *Dunlop* test is to be applied only in circumstances where there has been a breach of contract. This is partly because the judicial approach in Singapore is that of minimal intervention in contractual bargains. It is one thing to impose the *Dunlop* test to LD clauses, which are secondary contractual obligations. However, it would be too interventionist for the court to do so when there is no breach of a primary contractual obligation.

Implications of the *Denka* Decision

Because the *Dunlop* test applies only when there has been a breach of contract, parties may enforce LD clauses that are penal in nature so long as there is no breach of contract. For example, in relation to gas sales agreements with 'take or pay' obligations. The obligation to pay for gas that the buyer did not take is unlikely to be unenforceable for being penal.

On the other hand, if the LD clauses kick in only upon a breach of contract, then parties are well advised to familiarise themselves with the LD regime in Singapore. For example, construction contracts that impose LDs for failing to meet the completion date would be subject to the *Dunlop* test in the event of a breach of contract (i.e., not completing in time).

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