

Liquidated Damages Clauses: Key Issues, Problems, and Solutions

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Liquidated Ascertained Damages (“LAD”) clauses are a prevalent feature in construction, engineering, IT, and software contracts. In the context of software development contracts, LAD clauses assume heightened importance due to the structured nature of development methodologies, particularly the traditional **waterfall model**. Under this model, software development is carried out in sequential phases, where each phase builds upon the completion of the previous one. Given its rigid and linear progression, any delay in one phase inevitably cascades down the development timeline, amplifying the risk of project overruns and failed system implementations. Consequently, LAD clauses serve as a crucial safeguard, incentivising timely performance and compensating for disruptions that could jeopardise project completion.

Building on the foregoing, this write-up examines two key questions recently posed by some of our clients in relation to LAD clauses:

- Whether a claimant must suffer actual loss before enforcing a LAD clause; and
- Can a limitation of liability clause restrict LAD?
- Whether LAD Clauses are enforceable in the event of termination?

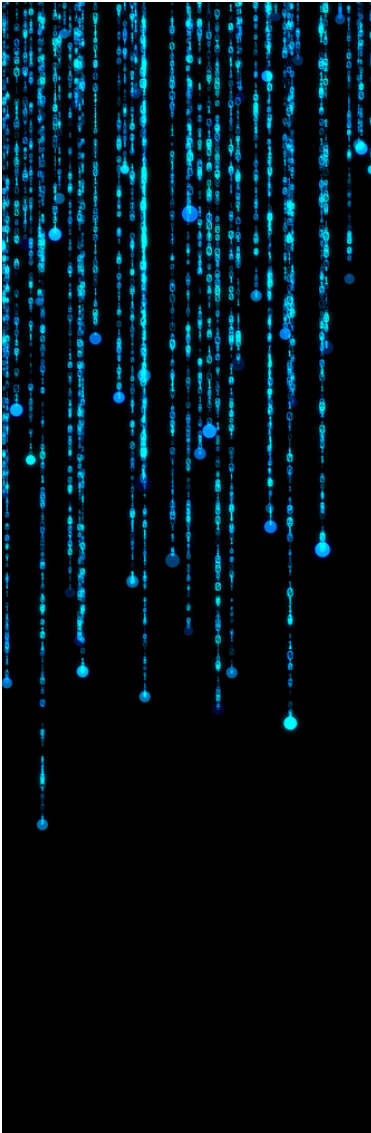


1) Actual Loss?



The short answer is no – it is not a precondition that actual loss must be suffered before a claimant can enforce an LAD clause. This principle was unequivocally affirmed by the Federal Court in ***Cubic Electronics Sdn Bhd (in liquidation) v Mars Telecommunications Sdn Bhd* [2019] 6 MLJ 15**.

In ***Cubic***, the Federal Court departed from the earlier rigid interpretation in ***Selva Kumar Murugiah v Thiagarajah Retnasamy* [1995] 1 MLJ 817**, which required claimants to prove actual loss before recovering LAD. Instead, the Federal Court held that once a breach has occurred, a claimant is entitled to enforce an LAD clause against the defaulting party, provided that the sum is not exorbitant or unconscionable. Once a breach is established, the burden then shifts to the defaulting party to prove that the LAD clause is unenforceable.



However, that is not the full story. While proving actual loss is not a precondition for enforcing an LAD clause, the Federal Court in **Cubic** held that it remains a relevant factor in determining whether the LAD clause falls foul of **Section 75 of the Contracts Act 1950**, which reads as follows:

“When a contract has been broken, if a sum is named in the contract as the amount to be paid in case of such breach, or if the contract contains any other stipulation by way of penalty, the party complaining of the breach is entitled, whether or not actual damage or loss is proved to have been caused thereby, to receive from the party who has broken the contract reasonable compensation not exceeding the amount so named or, as the case may be, the penalty stipulated for.”

Pursuant to this clause, an LAD clause would not be enforceable if the compensation payable under the clause is deemed excessive or disproportionate to the breach. In this regard, actual loss may still become a relevant factor in disputes where a defendant seeks to challenge the enforceability of an LAD clause. A defaulting party may argue that the stipulated LAD sum is manifestly excessive and does not reflect a reasonable estimate of potential loss. Accordingly, if a defendant establishes that actual loss is negligible or non-existent, this may constitute persuasive evidence that the LAD clause is punitive rather than compensatory, thereby rendering it unenforceable.

2) Can a Limitation of Liability Clause Restrict LAD?

Whether a limitation of liability clause applies to Liquidated Ascertained Damages (LAD) depends on the precise wording of the contract. Unless the contract expressly excludes LAD from the limitation clause, it is likely that LAD will be subject to the cap. This was the position taken by the UK Supreme Court in **Triple Point Technology Inc v PTT Public Co Ltd [2021] 3 WLR 521**.

In **Triple Point**, the contract contained a broad limitation of liability clause (Article 12.3), which provided that the contractor’s total liability would be capped at the contract price, save for cases involving fraud, negligence, gross negligence, or willful misconduct. The clause did not expressly distinguish between general damages and LAD.

When the dispute arose, PTT argued that LAD should not be subject to the liability cap, contending that a pre-agreed sum for liquidated damages was distinct from general damages and should not be constrained. The Court of Appeal initially agreed, but the Supreme Court took a different view, holding that LAD fall within the scope of a general liability cap unless expressly excluded.





Accordingly, if the intention is to ensure that LAD remains enforceable without being subject to liability caps, the contract should explicitly state that LAD is excluded from any general limitation of liability clause. A failure to address this issue at the drafting stage can lead to substantial disputes, particularly in contracts where LAD represent a significant financial exposure. In the absence of clear and express carve-outs, it can be reasonably expected that the courts will apply the limitation of liability cap to LAD.

3) Whether LAD Clauses are enforceable in the event of termination?

This question was also considered in *Triple Point*. *Triple Point* contended that the relevant LAD clause was only triggered where delayed work had been completed and accepted prior to termination. In rejecting this argument, the Supreme Court held that the accrual of LAD was not contingent upon the completion or acceptance of work but rather on the mere fact of delay beyond the agreed contractual deadlines. The Supreme Court emphasised that termination does not extinguish accrued LAD liability but merely halts the further accrual of such damages beyond the termination date. A similar approach was taken in *Liberty Technology Resources Sdn Bhd v Suruhanjaya Syarikat Malaysia (SSM) [2023] 11 MLJ 850*, where the Malaysian High Court rejected the argument that termination extinguished LAD liability.

These principles on LAD obligations before and following termination provides certainty for both parties—employers can recover LAD for pre-termination delays, while contractors are protected from indefinite LAD accrual beyond termination. Contractors should be mindful that termination does not extinguish accrued LAD liability, and any challenge to enforcement would require proving that the clause is excessive or unconscionable, a theme that was also emphasised in *Liberty Technology Resources*.



4) Conclusion

LAD clauses are a critical risk management tool, but their enforceability depends on clear and precise drafting. As commercial transactions grow in complexity, disputes over LAD continue to surface, particularly in industries where delays and performance obligations carry significant financial consequences. Well-drafted contracts not only safeguard parties' interests but also enhance certainty in enforcement. To mitigate disputes and protect commercial objectives, parties should ensure contractual clarity and seek legal advice at the earliest indication of ambiguity.

For further assistance on any legal matters, please do not hesitate to contact any of the authors.



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