

The employer's risk?

Focus on Legal by **Bernard G Lynch**

Construction is a risky business. There has been a trend in construction contracts over the last few years to burden the Contractor with more of the risk. These days one sees terms in contracts making the Contractor responsible for such varied risks as ground conditions, the quantities and descriptions in the Bills of Quantities, and even the Architect's design!

However, throughout the history of construction, the Contractor has normally carried the risk of completing the works on time. This is one of the factors that makes liquidated damages a common feature of construction contracts.

Liquidated damages are stated in the contract at a rate per day. If the Contractor fails to complete the Works before the date for completion, then the amount of liquidated damages can be readily ascertained by multiplying the number of days delayed by the daily rate of liquidated damages.

In law, liquidated damages are not like general damages. Liquidated damages require that the amount stated as liquidated damages in the contract, is a reasonable pre-estimate, made at the time of contract, of the likely loss flowing from any breach. Furthermore both the Employer and Contractor must agree on the amount stated in the contract as liquidated damages. In such situations the Employer can recover the amount of liquidated damages without the need to prove any loss or even to apply to arbitration or court.

With general damages, on the other hand, the law requires that before a party can recover, he must prove (on the balance of probabilities) that the other party's breach of contract "caused" the damages and also the amount of those damages. Furthermore, short of agreement between the parties, only an arbitration tribunal or court can actually award damages to the injured party.

In other words, without a term allowing the deduction of liquidated damages in the contract, or importantly if the liquidated damages clause in the contract was held to be invalid or unenforceable, an Employer would have to demonstrate that the Contractor caused delay to the completion of the Works, and as a result of that delay, the Employer suffered loss (of rent or such). The Employer would need to demonstrate and prove the amount of loss suffered.

The Employer would be required to convince an arbitrator or court of the Contractor's delay and the loss flowing from that delay. And only when the arbitrator or court issued judgement, could the Employer recover the loss. The use of lawyers, witnesses and experts would ensure that the Employer's road to recover his loss would be long and costly. Judgement may not be issued until two or three years after completion.

Yet with a liquidated damages clause in the contract,

the Employer can determine the total amount of liquidated damages pursuant to the contract and deduct this amount from payment due to the Contractor. No application to arbitration or court is necessary. Depending on one's position, one could even say that it was all quick and painless.

Liquidated damages clauses in contracts provide benefits for both the Employer and Contractor. For the Contractor, he is aware of his maximum risk and can include for this in his tender. For the Employer, the right to liquidated damages means that he has no need to provide evidence demonstrating that the Contractor's delay caused loss, or to prove the amount of that loss. No application to court or arbitration is required with the corresponding saving in time and costs. The Employer receives payment of the due amount of liquidated damages quickly.

However, where a liquidated damages clause is applicable, even although the law does not require the proof of causation or loss, the Employer is normally only due liquidated damages for the delay actually caused by the Contractor. Were the situation otherwise, then there could arise the situation whereby the greater the delay caused by the Employer, the greater the amount of liquidated damages he could recover.

Thus in order to be certain of his right to liquidated damages the Employer must allow the Contractor extensions of time for all delays that were caused by the Employer. If he fails to do this, and on application to court or arbitration, the Contractor may be able to have the liquidated damages clause declared invalid or unenforceable. The Employer could lose his right to liquidated damages and instead have to prove his entitlement to general damages by proving the delay and amount of loss. This is so even where both the Contractor and Employer have caused delay.

In fact, even if the Contractor had caused six months delay, all that may be required to have an arbitrator or court declare the liquidated damages clause invalid or unenforceable would be for the Employer to cause one day's delay. It seems that the mere fact that the Employer

caused (one day's) delay for which he could not award an extension of time, could render the liquidated damages clause or invalid or unenforceable.

The Australian case of **Gaymark Investments v Walter Construction Group (1999)** concerned a condition precedent that the Architect could not award the Contractor an extension of time, unless the Contractor had submitted a notice within a particular period. The Contractor had caused delay to the Works. However, the Employer had also caused delay to the Works, but the Contractor had failed to submit the required notice, for the Employer's delay, within the stipulated period. As a result of the Contractor's failure to submit the required notice, the Architect had no power to award an extension of time under the Contract for the delay caused by the Employer. Yet even so the Employer deducted liquidated damages.

The Contractor applied to arbitration and, on appeal, to court for refund of the liquidated damages. The court held that it was actually the Employer who took the risk that the Contractor would not comply with the requirements stipulated in the contract as conditions precedent to being granted an extension of time. Furthermore, the court held that as it was the Employer himself who had caused the delay, then no liquidated damages at all could be deducted.

The Employer was thus thrown back to his common law right of general damages and had to prove causation and actual loss in arbitration. This involved the Employer in considerably more time and expense before the damages for the delay, proven to be caused by the Contractor, could be recovered.

However in a more recent Scottish case, **City Inn Limited v Shepherd Construction Limited (2001)**, the court found that where the Contractor had failed to comply with the condition precedent in the contract and submit a notice within the prescribed period, even although the delay was caused by the issue of an Architect's instruction, and the Architect had no power to award an extension of time, the Employer's right to deduct liquidated damages was unaffected.

Thus, with regard to situations where the Employer causes a delay, and the Contractor fails to comply with a condition precedent such that the Architect has no power to award an extension of time, the law in Hong Kong is uncertain. On the one hand Hong Kong may follow the Australian decision and hold the Employer's right to liquidated damages invalid, and on the other hand it may follow the Scottish courts and declare the deduction of liquidated damages valid.

However, with this uncertainty in the law, it seems important for Employers and the drafters of contracts to consider that the more difficult the requirements a Contractor must comply with in order to be awarded an extension of time, the less likely that the Contractor will "actually comply" with such requirements and correspondingly, the less likely that the Architect will have the power, under the contract, to award an

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extension of time. And if the Architect cannot award an extension of time, and if any part of that delay was caused by the Employer then, in the absence of legal certainty, the Employer's right to recover liquidated damages becomes at risk.

It also seems important for Employers and the drafters of contracts to consider that the more difficult the requirements a Contractor must comply with in order to be awarded an extension of time, the less likely that the Contractor will "be able to comply" with such requirements. Most of the time compliance with the drafted terms is possible but in some cases the terms are so onerous (or poorly drafted) that compliance may well be impossible. For example a term requiring the Contractor to submit "full particulars within 28 days of the commencement of the delay" becomes impossible to comply with if the delay extends beyond 28 days. Yet, if the Contractor does not comply with the terms, simply because compliance was impossible, the Architect still has no power to award an extension of time. In this situation, it seems certain that the Employer's right to recover liquidated damages is lost.

Nowadays, it is common that terms are inserted into the Contract making the Contractor's submission of particulars and/or programmes, correspondence (etc) all within a specified time period, a condition precedent to the Architect having the power to award of an extension of time. Sometimes these terms require the Contractor to make a simple submission within the specified period, at other times the submission required is voluminous. Sometimes compliance with these terms is possible, sometimes it is impossible.

Yet the Architect's power to award an extension of time, may be solely dependant on the Contractor's compliance with such a term. If the Contractor fails to comply with the specific requirements of the term, even if only for the reason that compliance with such requirements is impossible, then the Architect cannot award an extension of time.

On first glance, the Contractor's compliance with these terms seems to be solely at the Contractor's risk in that the Contractor would lose his right to an extension of time if he did not comply. However, the reality is that if any part of the delay was caused by the Employer, then, depending on which judgment is followed, it may be the Employer who carries the risk of losing his right to recover liquidated damages. And if the Contractor's compliance with the terms was impossible then it seems certain that it is the Employer who carries the risk... 