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Newsletter

Construction

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What's inside?

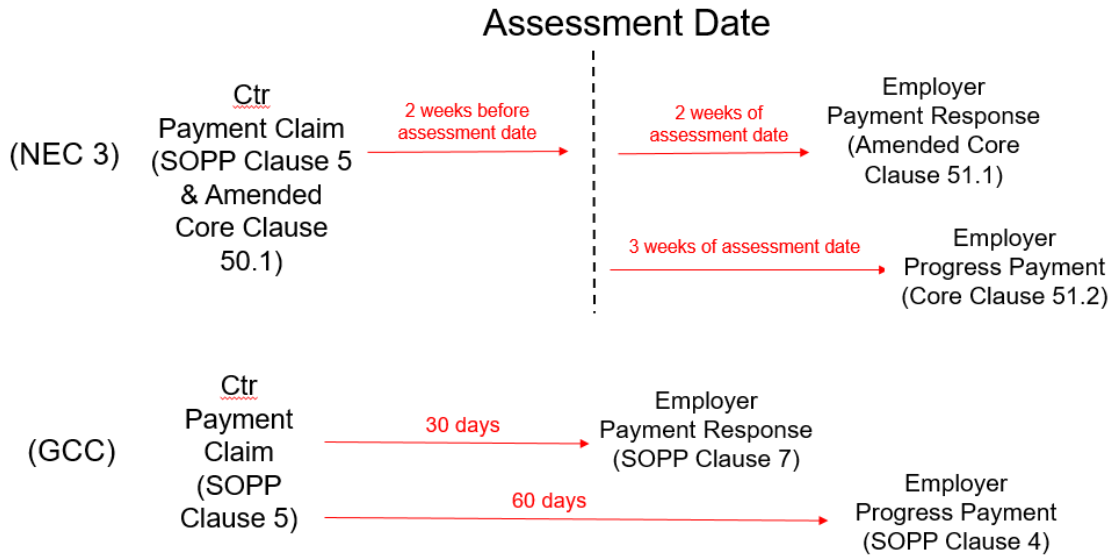
What if my Payment Claim / Payment Response does not comply with the requirements under the Security of Payment Provisions in Public Works Contracts?

Joseph Chung

In the last article, we briefly discussed the framework of the Development Bureau's Technical Circular on Security of Payment Provisions in Public Works Contracts (SOPP) issued in October 2021.

In this second of the series of articles on SOPP, we will discuss compliance with the payment process provisions in the SOPP and how non-compliance with such provisions may affect the parties' rights under the SOPP framework.

The timeframe for a contractor to serve a Payment Claim and the employer to serve a Payment Response can be best illustrated in the flowcharts below:-



SOPP Clause 5 requires a Payment Claim to:-

- be in writing;
- identify the construction work or related goods and services to which the payment relates; and
- state the amount of the progress payment that the contractor claims to be payable.

A payment application that contains the above ingredients is taken as a Payment Claim (SOPP Clause 5(7)).
SOPP Clause 6 requires a Payment Response to:-

- be in writing;
- identify the Payment Claim to which it relates;
- state the amount (if any) admitted as due under the contract before set off or withholding, and the basis of calculation of that amount;
- state the amount (if any) not admitted as due under the contract before set off or withholding, the grounds for, and the basis of calculation of that amount;
- state the amount, the grounds, and the basis of the calculation of any amount to be set off or withheld; and
- state the net amount to be paid (if any) and the calculation of the amount.

A payment certificate or assessment under the contract in response to a Payment Claim or payment application that contains the above ingredients is to be taken as a Payment Response (SOPP Clause 6(4)).

Under the SOPP, a contractor may only commence adjudication if a "payment dispute" arises (SOPP Clause 10(1)). SOPP Clause 9 identifies the circumstances in which a "payment dispute" will arise.

In short, a payment dispute arises if the contractor has served a Payment Claim compliant with SOPP Clause 5 on the employer and:-a

(1) the employer has served a Payment Response on the contractor under SOPP Clause 6 in which:-

  (a) the Payment Claim is disputed (in part, in its entirety and / or arguments of set off / withholding are raised);
  (b) a net amount is admitted as due and is to be paid but the employer has failed to pay the net admitted amount in full by the due date; or

(2) the employer does not serve a Payment Response under SOPP Clause 6 in reply to the Payment Claim.

The following interesting questions arise. What if the Payment Claim / Payment Response is not served within the requisite timeframe? What if the Payment Claim / Payment Response does not contain all the ingredients as required under SOPP?

Whilst the UK statutory adjudication regime may differ from the SOPP in various aspects, some of the UK decisions (in the Technology and Construction Court) may provide useful insight in answering the above questions. Two such cases are set out below for illustration.

1. Downs Road Development LLP v Laxmanbhai Construction (UK) Ltd (2021)

Facts

The employer engaged the contractor under a construction contract, which provided for monthly payment application. The contractor issued a payment application for £1.9m. Under the UK legislation, Housing Grants, Construction and Regeneration Act 1996 (HGCRA), the employer was required to issue a payment notice to the contractor specifying the sum it considered due at the payment date, and the basis of the valuation. The employer first sent a payment notice 34 identifying the sum due to the contractor as £0.97. Six days later, the employer sent a second payment notice 34a which was out of time and specifying a much larger figure of approximately £657,200 as due. One of the issues raised in the Court in respect of a challenge to the Adjudicator's decision, was the validity of payment notice 34.

Held

The employer's payment notice 34 did not set out the amount which the employer actually considered to be due, rather it had sent the notice to gain time in order to make an assessment of the sum it actually believed to be due (i.e. payment notice 34a). Further, the notice did not set out the basis of the calculation; and that, accordingly, payment notice 34 did not comply with the requirements under HGCRA and was therefore invalid. However, in this case, the Court did not have to decide on the consequences of payment notice 34 being invalid because neither of the parties in the court proceedings had sought relief for this.

However, based on other UK decisions (such as S&T (UK) Ltd v Grove Developments Ltd (2018)), and under HGCRA, where the employer's payment notice / pay less notice is found to be invalid, the employer will have to make payment on the amount of the interim payment application. This can be contrasted with the SOPP which provides that if the employer does not serve a Payment Response, the employer will be regarded as disputing the full amount claimed but will not be able to raise any set-off in any adjudication in relation to the Payment Claim concerned (SOPP Clause 8). Referring to the UK line of authorities (as discussed above), it would seem that if the Payment Response failed to comply with the requirements under SOPP Clause 6 and is hence invalid, it would be taken that the employer did not serve a Payment Response and hence triggering SOPP Clause 8. There could be a similar effect with a non-compliant Payment Notice. An invalid Payment Notice could bring into question the validity of the corresponding adjudication proceedings as arguably, a "payment dispute" has not arisen (see above).

The UK Courts have repeatedly emphasised the importance that an "application for interim payment must be in substance, form and intent an interim application stating the sum considered by the contractor as due at the relevant due date and it must be free from ambiguity".

2. Jawaby Property Investment Ltd v Interiors Group Ltd (2016)

Facts

Under the subject contract, the contractor was required to make interim payment applications on the 8th of each month. On 5 January 2016, the employer sent an email to the contractor requesting the contractor to send "[its] valuation tomorrow morning". On 7 January 2016, the contractor responded by email saying "please see our initial assessment for Valuation 007, this is based upon Progress update and onsite review carried out earlier this week" (contractor's 7 January e-mail). The valuation was in the total gross sum of £2.4 million, as set out in a summary sheet and attached spreadsheets. The Court proceedings related to various declarations sought by the employer against the contractor. One of the issues that the Court had to determine was whether the contractor's 7 January email was a valid interim payment application under the contract.

Held

The 7 January e-mail did not comply with the requirements under the contract. It was merely an initial assessment. The valuation did not state what the contractor considered to be due to it. The Court considered that a reasonable recipient of the 7 January e-mail would not have regarded it as unambiguously informing the recipient that this was an interim payment application for the purposes of the contract.

The Court held that whether the above conclusion would lead to harsh results for the contractor, was an area where, as the case authorities made clear, there was little scope for latitude. If a contractor wished to have the benefit of an interim payment regime such as that contained in the contract, its application for an interim payment had to be in substance, form and intent an interim payment application stating the sum considered by the contractor as due at the relevant due date, and it had to be free from ambiguity.

Whilst one could say that the decision in Jawaby may have been influenced by the fact that under the UK legislation, HGCRA, if an employer does not serve a Payment Notice / Pay Less Notice, the contractor could be entitled to the sums that it had applied for under its payment application. One may say that equally, under the SOPP, if the employer does not serve a Payment Response because it was not apparent that a document which the contractor had served was alleged to be a Payment Claim, there could be significant consequences for the employer under SOPP Clause 8, hence the need for the alleged Payment Claim to be "in substance, form and intent", a Payment Claim compliant with the SOPP. To avoid any possible challenges to entitlement to payment in the case of the contractor or to set off / withholding in the case of the employer, it is important that the parties comply strictly with the SOPP provisions on the contents and format of the Payment Claim / Payment Response and also their respective timeframes.

This article was first published in the 2nd issue of HKICM newsletter in August 2022 and can be found here.

Court of Appeal holds demand for bonded sum invalid

Stanley Lo

In West Kowloon Cultural District Authority v AIG Insurance Hong Kong Ltd, CACV 82/2020, the Court of Appeal allowed AIG's appeal, holding that the Court of First Instance (CFI) had erred in its construction and conclusion in respect of a bond obtained by the Contractor under a construction contract. The court found that on a proper construction, the bonded sum as demanded, included future damages and losses which were outside the ambit of the terms of the bond. Therefore, the demand was not made in compliance with the terms of the bond and was thus invalid. Please see our article on the CFI judgment.

Background

A bond had been obtained by the Contractor, Hsin Chong Construction Company Limited (Hsin Chong), from the Defendant, AIG Insurance Hong Kong Ltd (AIG), in favour of the Plaintiff, West Kowloon Cultural District Authority (West Kowloon), as required under a construction contract. Clause 2 of the Bond provided: "*If, in the [Plaintiff's] opinion, the Contractor is or has been in default in respect of any of his obligations under the Contract, the [Defendant] shall upon demand made by the [Plaintiff] in writing and without conditions or proof of the said default or amount demanded, pay the amount identified in the demand in respect of the damages, losses, charges, costs or expenses sustained by the [Plaintiff] by reason of the default, up to the amount of the Bonded Sum.*" (emphasis added).

Before the CFI, West Kowloon had applied for summary judgment against AIG on the basis that it had made a valid demand on the Bond and AIG had applied to strike out the action on the ground that the demand letters relied upon by West Kowloon did not constitute valid demands upon the Bond as: (i) they did not identify the amount of damages, losses, charges, costs or expenses sustained by West Kowloon by reason of Hsin Chong's alleged default; and (ii) they purported to demand payment of the full Bond sum in respect of an unidentified amount of future or prospective damages etc, which were not within the terms of the Bond.

The demand in question was the 1st Demand, the relevant part of which stated:

"We refer to the above bond issued to you in our favour, under which you are the Bondsman.

We hereby demand that you pay to us the full bonded sum of HK$297,198,000.

We are of the opinion that the Contractor is and has been in default in respect of various of its obligations under the Contract between the Contractor and us, and by reason of such defaults we have suffered and sustained and will continue to suffer and sustain damages, losses, charges, costs and expenses".

The CFI held that the 1st Demand complied with the requirements of Clause 2 of the Bond because it was very clear that proof of Hsin Chong's default or amount demanded was not necessary and all that was required under Clause 2 was: (i) a written demand by West Kowloon; (ii) in West Kowloon's opinion, Hsin Chong was or had been in default in respect of its obligations under the Contact; and (iii) the amount stated in the demand was in respect of the damages, losses, charges, costs or expenses sustained by West Kowloon by reason of the Contractor's default. The 1st Demand satisfied all three requirements and was therefore a valid demand on the Bond.

The Defendant now appealed on the grounds that (i) the judge erred in finding that the Plaintiff's failure to state that the amount demanded was in respect of losses, charges, costs or expenses sustained by reason of the Contractor's default did not render the 1st Demand invalid (Ground 1); (ii) the Judge erred in finding that the 1st Demand was valid even though it plainly included a claim for losses which the Plaintiff had not yet sustained as at the date of the 1st Demand (Ground 2).

The Court of Appeal allowed the appeal, holding:

(1) There was no dispute that, as a matter of construction, the 1st Demand (in particular paragraphs 2 and 3) should be read and construed together objectively and in proper context. When reading the plain words of paragraphs 2 and 3 together and with common sense, the Plaintiff was clearly stating in the 1st Demand that it was demanding the Bonded Sum under the Bond as it related to the Contractor's default under the Contract.

(2) The plain and express words of the 3rd paragraph of the 1st Demand objectively and reasonably inform the reader that the Bonded Sum as demanded related to damages and losses that had already been suffered by the Plaintiff as well as ones that are yet to be suffered by reason of the Contractor's default under the Contract.

(3) Under Clause 2, the Plaintiff can only validly demand payment for damages, and losses that they have already suffered and sustained at the time of demand, and objectively, it is a permissible construction of paragraph 3 of the 1st Demand that the demanded Bonded Sum included damages and losses which the Plaintiff would continue to suffer after the time of the demand, i.e., in the future.

(4) The operative words used in Clause 2 are "damages, losses, charges, costs or expenses". These are words or terms referring to actual or quantified amounts. Hence, it is intended under Clause 2 that when the Plaintiff makes a demand, it should be by reference to damages, losses etc which have already been suffered and quantified, but not unquantified sums arising from or by reason of the Contractor's default. This intention is underlined by the fact that under the Bond, the Plaintiff can make multiple and subsequent separate demands.

(5) There was nothing before the court which would show and support the position that at the time of the 1st Demand, there was an objective context or basis to say that the quantified damages were already well beyond the Bonded Sum.

(6) The CFI had erred in its construction and conclusion. On a proper construction, the Bonded Sum as demanded under the 1st Demand included future damages and losses which were outside the ambit of Clause 2. Therefore, the 1st Demand was not made in compliance with Clause 2 and was thus invalid.

Comment

This judgment may put great burden on those who are responsible for drafting a demand under the performance bond. In particular, it is not uncommon that at the time of issuing the demand, the loss and damage sustained cannot be properly quantified. Some performance bonds may have an expiry date e.g. after the issue of the Substantial Completion Certificate or Defects Rectification Certificate. If the demand is only held to be invalid after the expiry date of the bond, the employer may not be able to issue a fresh demand for rectifying the defects in the first demand.

Variation of works - a reminder to comply with contractual requirements

KK Cheung

Where a construction contract stipulates that variation works shall be carried out only with written instructions from a designated person, can a contractor nevertheless get paid on his variation claims because he trusted that he would be paid, notwithstanding what the contract said? That was the issue before the High Court of Singapore in *Vim Engineering Pte Ltd v Deluge Fire Protection (SEA) Pte Ltd* [2021] SGHC 63. The contractor (Vim) argued that "a gentleman's word is his bond", and so its employer (Deluge) should pay for variation works that had been orally requested, although the contract between the parties stipulated that variation works shall be carried out only with written instructions from Deluge's project manager (and there were no such written instructions). The court held that Vim's variation claims failed because there were no written instructions from Deluge's project manager as required under the Subcontract and there was no waiver or estoppel in this regard. This case serves as a reminder for contractors to ensure that they fully comply with the contractual requirements for variation of works.

Background

Deluge, was a subcontractor for a construction project. Deluge subcontracted part of the works to Vim (Subcontract). Vim left the project before completion of the main works and later claimed from Deluge the balance it said was due for the main works and also an amount for alleged variation works.

Variation works provision in Subcontract

Clause 16 of the Subcontract provided that *"[a]ny variation work such as [additions] or [omissions] or [modifications], shall be on a back-to-back basis with the Main Contract.* ***Such variation shall be carried out only with written [instructions] from [Deluge's] Project Manager*** *… [Vim] shall be entitled to ninety percent (90%) … or shall allow a discount of 10% (Profit & Attendance) for [Deluge], on any approved variation claim for additional work orders*".

Vim accepted that it did not have any written instructions to support its variation claims, but argued that Deluge was estopped from denying its claims because Deluge had allegedly waived the requirement for "written instructions", verbally

instructed Vim to carry out the variation works, assured and/or represented to Vim that Deluge would pay the claim for variation works and/or accepted Vim's invoices for variation works by signing on them.

Court's Decision

No written instructions

The court held that there were no written instructions from Deluge's project manager for the purpose of variation works and variation claims under clause 16 of the Subcontract and, therefore, the contractual conditions for a successful variation claim by Vim were not satisfied.

The court noted that the requirement of written instructions from a designated person serves various objectives and that these objectives would be defeated if the designated person (or his subordinate) could dispense with written instructions, which the parties had contractually stipulated for. First, it provides for a written record, thus obviating disputes as to what was allegedly said (which happened in the present case). Second, it focuses the parties' attention, at the time, on whether in principle there may be an adjustment to the contract sum. If, without written instructions, Vim proceeded to do work that it considered to be a variation, it did so at its own risk. The court added that firming up the parties' positions contemporaneously as to whether variation works are involved is better than fighting about it in court (and in hindsight) long after the project.

No waiver or estoppel

The court found that there was no waiver or estoppel.

Vim asserted that it acted on verbal instructions, but the court said that this in itself could not amount to a waiver or estoppel in relation to a contractual clause requiring written instructions (i.e. clause 16 of the Subcontract). The alleged giving of verbal instructions simply meant that the contractual requirement of written instructions had not been complied with.

As regards Vim's argument that "a gentleman's word is his bond", so Deluge should pay notwithstanding the lack of written instructions, the court said that Vim gave its word, as embodied in clause 16 of the Subcontract, that it would only carry out variation works with written instructions from Deluge's project manager. In not paying for alleged variation works carried out without such written instructions, Deluge was simply honouring what the parties had contractually agreed to in clause 16 of the Subcontract.

In relation to Vim's argument that Deluge had accepted Vim's invoices for variation works by signing on them, the court accepted Deluge's argument that when they signed the invoices they were just acknowledging that the works had been carried out and not that these were variation works or that they would be paid for them.

The court said that Vim's plea that it trusted that Deluge would pay, did not avail Vim. Since Vim contracted on the basis that it would only carry out variation works with written instructions from Deluge's project manager, it should have expected its variation claims to be rejected for the lack of such instructions.

Comments

The usual way for contractors to argue that they are entitled to be paid based on verbal instructions is to rely on waiver or estoppel. There must be conduct of one party which leads the other party reasonably to believe that the strict legal rights would not be insisted on. In order to succeed, the contractor has to prove that it suffered a detriment as a result of the conduct of the employer. Vim failed to prove any detriment. In *UBC (Construction) Limited v Sung Foo Kee Limited* [1993] 2 HKLR 207, the Hong Kong Court found that the main contractor gave every encouragement to the sub-contractor to get on with the work, carry out the variation orders (and paid some of them in full) and employed men on their behalf – all of this in the context that the sub-contractor would be paid for the work although they did not comply with the contractual requirements that agreements and notices must be in written form.

How will an employer's acts of prevention affect a liquidated damages clause?

Justin Yuen

In *Crescendas Bionics Pte Ltd v Jurong Primewide Pte Ltd* [2021] SGHC 189, the High Court of Singapore ordered the Defendant to pay general damages to the Plaintiff for delays in the completion of a construction project. It held that the Plaintiff could still recover damages, notwithstanding that the Plaintiff had caused acts of prevention, leading to delays in completion of the project. The court rejected the Defendant's argument that the amount of general damages recoverable by the Plaintiff should be capped at the amount of liquidated damages that the Plaintiff would have been entitled to under the liquidated damages clause in their agreement, had it not committed the various acts of prevention.

Background

The Plaintiff, a property developer, and Defendant, a general building contractor, signed a Letter of Intent (LOI) under which the Plaintiff engaged the Defendant as management contractor to build the 3rd phase of a business park development (Biopolis 3). Clause 6.0 of the LOI provided that, in the event of a delay in completing the construction of Biopolis 3, the Defendant would be liable to pay the Plaintiff liquidated damages for late completion of a specified amount.

The parties' relationship deteriorated, as they disagreed on their respective obligations and the scope of responsibilities under the LOI. In addition, there were delays in the completion of Biopolis 3. It was undisputed that the time taken for completion exceeded the time period of 18 months stipulated in the LOI for the Defendant to complete Biopolis 3. The Plaintiff thus brought proceedings against the Defendant and the Defendant also brought various counterclaims against the Plaintiff.

Judgment on Liability

Previous High Court and Court of Appeal judgments had ruled on liability, holding that:

(i) completion of Biopolis 3 had been delayed by 334 days in total;
(ii) the Plaintiff was responsible for 173 days of the delay, caused by its acts of prevention;
(iii) as the Plaintiff was responsible for 173 days of delay due to its acts of prevention, the Defendant was no longer bound to complete Biopolis 3 within 18 months as stipulated under clause 5.0 of the LOI. Consequently, the Plaintiff's right to claim liquidated damages under clause 6.0 of the LOI no longer applied; and
(iv) the Defendant was responsible for 161 days of the delay. On this basis, the Defendant was liable to the Plaintiff for general damages for 161 days of delay.

Assessment of Damages

In these proceedings, the Plaintiff sought an assessment of the general damages due to it in respect of the 161 days of delay for which the Defendant was responsible, as the contractual provision on liquidated damages in the LOI was rendered inoperative as a result of the Plaintiff's acts of prevention.

Defendant's position

The Defendant contended that any general damages payable by it to the Plaintiff for the delay caused by the Defendant could not exceed the liquidated damages that the Plaintiff could have obtained under clause 6.0 of the LOI, had it not committed the various acts of prevention. The Defendant argued that the parties' fixation on the liquidated damages rates during the negotiations indicated that the parties contemplated that the total amount of liquidated damages recoverable under clause 6.0 of the LOI would act as a cap on the total amount of general damages for which the Defendant would be liable in the event of a delay.

In the alternative, the Defendant argued that the amount of liquidated damages recoverable under clause 6.0 of the LOI ought to act as a cap on the Defendant's liability as a matter of law.

Plaintiff's position

The Plaintiff contended that it was entitled to the full extent of the general damages that it was able to prove to the court, as there were no express exclusion or cap (whether in the LOI or agreed between the parties) on the quantum of general damages the Plaintiff could recover.

Court's Decision

The court rejected the Defendant's argument that any general damages payable to the Plaintiff for the delay could not exceed the liquidated damages that the Plaintiff could have obtained under clause 6.0 of the LOI had it not committed the various acts of prevention, because, notwithstanding the Plaintiff's acts of prevention, the Defendant still exceeded the reasonable time for the completion of Biopolis 3 and was responsible for 161 days of delay.

The court said that general damages and liquidated damages are underpinned by different considerations. General damages are intended to compensate the innocent party for the actual losses suffered as a result of the breach. In contrast, liquidated damages are intended to be a genuine pre-estimate of the likely losses that would be suffered in the event of a breach. Furthermore, clause 6.0 of the LOI was a contractual term which the parties had willingly agreed to be bound by in the event of a delay. Hence, there was no principled reason for capping the amount of general damages recoverable by the Plaintiff in these proceedings.

The court added that although the Plaintiff was responsible for 173 days of delay due to its acts of prevention, the Defendant nevertheless exceeded the reasonable time for the completion of Biopolis 3, which was 18 months. The Defendant was, therefore, still responsible for 161 days of delay. In these circumstances, it would not be inequitable to allow the Plaintiff to recover general damages exceeding the amount of liquidated damages provided for in clause 6.0 of the LOI.

Comments

The High Court of Singapore in this case came to the opposite conclusion to that of England's Technology and Construction Court (TCC), made a few days earlier in Eco *World-Ballymore Embassy Gardens Company Limited v Dobler UK Limited* [2021] EWHC 2207. In that case, the liquidated damages clause was found to still apply, but the court commented that had the liquidated damages clause been found to be a penalty and unenforceable, the cap contained in that clause would still apply to general damages for delay. The court found that the intention of the parties was that the Defendant's liability for delay damages would be so limited.

The interpretation of a liquidated damages clause depends on the wording of the clause itself and the circumstances known to or assumed by the parties at the date of the contract. It is not surprising that different courts may reach different conclusions, having taken into account the above factors in each case.

Want to know more?

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