

Financing Charges

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In my article last month I discussed the question as to when a contractor is entitled to claim interest. Whilst it was affirmed that the position at common law is that a debt which is paid late does not give an entitlement to interest, it was recognised that there are a number of exceptions to this rule.

Probably the most important exception for contractors in their everyday business is that interest can be claimed where it forms a constituent part of the claim itself.

What this means can be simply explained as follows:

- A contractor will allow in its tender for financing charges that it will pay the bank on the working capital required to carry out the works.
- If additional works are instructed and/or delays occur that result in an extension of the time for completion of the works, then the contractor will pay more finance charges to the bank than allowed for in its tender.
- If the delays that have occurred are caused by events that entitle the contractor to claim the direct loss and expense or Costs incurred, then these additional finance charges are recoverable as a constituent part of the direct loss and expense.
- The financing charges are therefore not a claim for interest on a debt due, but are part of the actual debt itself.

This position which is now settled law was first established in the famous case of *F G Minter Ltd v Welsh Health Technical Services Organisation* (1980) where the court interpreted the claims provisions in the contract in an entirely sensible manner. The judge made the following observations:

*“(In) the building and construction industry the 'cash flow' is vital to the contractor and delay in paying him for the work he does naturally results in the ordinary course of things in his being short of working capital, having to borrow capital to pay wages and hire charges and locking up in plant, labour and materials capital which he would have invested else-where. The loss of the interest which he has to pay on the capital he is forced to borrow and on the capital which he is not free to invest would be recoverable for the employer's breach of contract within the first rule in *Hadley v. Baxendale* without resorting to the second, and would accordingly be a direct loss, if an authorised variation of the works, or the regular progress of the works having been materially affected by an event specified .. has involved the contractor in that loss.”*

These principles were further accepted and developed in the case of *Rees & Kirby Ltd v Swansea City Council* (1986) where it was additionally confirmed that finance charges calculated on the basis of compound interest were payable. This was in recognition of the fact that this is the way in which banks charge (or pay) their customers interest.

Under the HKIA/RICS forms of contract that give the contractor an entitlement to claim its direct loss and expense it is clear that a contractor is entitled to claim either interest paid to the bank on an increased overdraft facility (expense) or interest foregone on monies that could otherwise have been invested (loss).

Under the Hong Kong Government (and MTRC and KCRC contracts) however there is some doubt whether a contractor is entitled to claim interest foregone on monies that could otherwise have been invested.

This is because those forms of contract give the contractor an entitlement to Costs rather than direct loss and expense, and Costs (in the HK Government contracts) are defined as:

“... expenditure reasonably incurred including overheads whether on or off the Site and depreciation in value of Constructional Plant owned by the Contractor but excluding profit.”

which prima facie would appear to rule out interest foregone on a sum that could have been invested because such does not appear to fall within the definition of expenditure reasonably incurred.

However, whilst it was clearly the intention of the Government when drafting the contract to restrict Cost claims to 'expenditure' and not losses, there is some authority to suggest that the above definition of Costs may not have the desired effect.

In *Re: Stratton's Deed of Disclaimer (1957)* the court considered that the word 'expense' (the act of incurring expenditure) should be defined as the Oxford Dictionary definition being "cost or sacrifice involved in any course of action". In this case interest lost on capital which a contractor is not free to invest is clearly a sacrifice.

Therefore it appears possible that under both the HKIA/RICS forms of contract and the Hong Kong Government (including KCRC and MTRC) forms, a contractor when claiming loss and expense or the Costs incurred under the various provisions of those contracts is entitled to claim, as a constituent part of that loss and expense or cost, additional finance charges that it has paid to the bank as a result of the matter giving rise to the claim, or interest lost on monies that it could, but for the event, have invested.

(Adopted from the HKIS Newsletter 8(9) September 1999)