

A Question of Interest

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The question as to when a contractor is entitled to claim interest is one, which arises regularly, and is one, which traditionally causes confusion.

The position at common law is settled, if somewhat surprising in the current commercial world, and is that a debt which is paid late does not give an entitlement to interest. This position derives from the famous case in 1893 of *London, Chatham and Dover Railway v South Eastern Railway*, and was more recently affirmed by the House of Lords in the *President of India v. La Pintada Cia Navegacion* (1984).

Therefore if a contract provides that the employer shall pay to the contractor any sums certified within 14 days of the date of certification, if he fails to make payment until say 60 days later, the debt is discharged and the contractor can not bring an action for interest arising from the late payment.

However, there are exceptions to this general rule, and there are four situations where a contractor can claim interest. These are as follows:

- **Where there is an express term in the contract providing for interest in specific circumstances.**

A good example of this is the Government of Hong Kong SAR General Conditions of Contract Clause 79(4)(a) that provides "*In the event of the failure by the Employer to make payment to the Contractor in compliance with the provisions of this Clause (Interim and Final Payments) the Employer shall pay to the Contractor interest at the judgement debt rate...*".

Therefore in the Government contracts if the Employer fails to pay to the Contractor a sum certified within 21 days, the Contractor can claim interest for the late payment.

It is interesting to compare this with the ICE Form of Contract that contains similar but importantly different wording in that it provides "In the event of failure by the Engineer to certify or the Employer to make payment. The Employer shall pay to the Contractor interest"

The ICE conditions thus enable the Contractor to seek interest on sums that he considers he was due but which the Engineer has failed to certify in an interim certificate. This is significantly wider than the Government Conditions that only permit interest on sums, which have already been certified but paid late.

With regard to other contracts in use in Hong Kong the KCRC Conditions follow the same line as the Government Conditions, but the RICS/HKIA Private Form of Contract which is used in almost every private development contain no provisions entitling the Contractor to interest for late payment and so the Contractor has no entitlement to claim interest for an Employers late payment under these conditions.

- **Where the interest forms a constituent part of the claim itself.**

Interest or finance charges can be validly claimed where such charges have been incurred by reason of matters giving a contractor entitlement to claim either loss and expense (under the RICS/HKIA Private Form) or Costs (under the Government forms) because

the interest or finance charge are part of the loss or expense or the Costs incurred.

This is an important area and a topic that I will address in detail next month.

- **Where statute provides for the payment of interest**

There are a number of situations where statute provides that interest may be paid on settlement of a debt.

For example, and with most relevance to the construction industry, if a dispute between a contractor and an employer is taken to court or arbitration, then the provisions of the High Court Ordinance (Cap 4), or the Arbitration Ordinance (Cap 341) empowers the court or an arbitrator to award interest on sums awarded.

The interest will normally be awarded from the date on which the payment should have been made, unless, for example there has been unreasonable delay on the part of the contractor in pursuing his claim.

It is important to note, however, that the contractor can only claim interest at the court or arbitrators discretion on a sum that is being claimed as due, and a claim for interest alone can not be made. For example, consider a dispute where the contractor is claiming entitlement to \$100,000 for some additional dredging carried out in January 1998. The Engineer refuses to certify payment and the contractor serves notice of arbitration in July 1999. The contractors statement of claim for the arbitration will be for \$100,000 plus interest at the discretion of the arbitrator. If the matters proceeds to arbitration and the arbitrator finds for the contractor he will normally award \$100,000 plus interest running from January 1998, i.e. the date when the payment should have been made.

However if the employer decides to pay the \$100,000 in June 1999 then (because of the common law rule) the debt is discharged, and it is not possible for the contractor to serve notice of arbitration solely to get the interest to which he considers himself entitled.

- **Where interest is claimed as a special damage.**

The final exception to the general rule that a person cannot claim interest merely because money has been paid late is where interest is claimed as a special damage. The developments in this area are the most interesting challenges to the old common law rule, and ones which may be of great significance to the construction industry.

In accordance with the landmark case of *Hadley v Baxendale* (1854) a wronged party is entitled to those damages that naturally arose from the breach of contract (the first limb of the decision known as general damages) and those damages that may reasonably be supposed to have been in the contemplation of both parties at the time the contract was made as a probable result of the breach (the second limb of the decision known as special damages).

In the case of *Holbeach Plant Hire Ltd v Anglican Water Authority* (1988) the court accepted that a contractor may be entitled to claim interest on sums that the Engineer should have certified as special damages, if it could be proven that the fact that the contractor would incur finance charges in the event that a late payment was made was in the contemplation of both parties at the time the contract was made.

This must be at least arguable in every construction contract in Hong Kong where contractors traditionally operate in an overdraft situation.

Whilst the common law position has remained unchanged for over one hundred years that a payee cannot claim damages by way of interest merely because money has been paid late, the situations above indicate the exceptions to the rule, and the final exception, the

area of special damages has the potential to make significant inroads into the traditional rule.

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