

## Surviving flow-down liability for liquidated damages: a guide for subcontractors \*

### I. Introduction

- 1 The construction sector in Singapore was valued at S\$33.4 billion in 2019.<sup>1</sup> This booming industry is expected to remain strong in 2020, due to the increasing complexity in the design of buildings, such as the rising emphasis on prefabrication technology.<sup>2</sup>
- 2 Construction projects are complex, and require many different skills and expertise. Any one contractor is unlikely to possess all the required skills and expertise, and will inevitably have to pass on some parts of the task to subcontractors. However, too many cooks may spoil the broth. With the numerous arrangements involved in a construction project, a single faulty component (or subcontractor) may derail the entire construction project and cause delays.
- 3 Liquidated damages (“**LD**”) clauses are a common measure for an employer to mitigate against delays caused by the main contractor. This same clause is often featured in subcontracts – they minimize the main contractor’s exposure to liability for delays caused by the subcontractor, and pass down the liability for LDs to the subcontractor. Unsurprisingly, LD clauses are one of the most common causes of disputes between main contractors and subcontractors as the payable amount can be quite substantial.<sup>3</sup>
- 4 This commentary will seek to explain the potential liability of a subcontractor for LDs arising from delays, and consider possible defences to be raised.

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<sup>1</sup> Building and Construction Authority, “Singapore’s Construction Demand for 2020 Expected To Remain Strong” (8 January 2020) <<https://www.bca.gov.sg/newsroom/Singapore-construction-demand-2020-MR08012020.html>> (accessed 23 January 2020).

<sup>2</sup> *Ibid*; see also The Straits Times, “Parliament: Construction industry gets \$295m to adopt new technology” (7 March 2019) <<https://www.straitstimes.com/politics/construction-industry-gets-295m-to-adopt-new-technology>> (accessed 23 January 2020).

<sup>3</sup> The Straits Times, “New mediation centre to resolve disputes in construction sector launched” (12 March 2019) <<https://www.straitstimes.com/singapore/singapore-contractors-association-unveils-mediation-centre-to-resolve-construction>> (accessed 20 September 2019).

## II. Discussion

### A. *What are liquidated damages?*

5 LDs are an amount of compensation which contracting parties have pre-agreed to be payable, should the contract be breached.<sup>4</sup> For example, a LD clause may state that “liquidated and ascertained damages of S\$30,000.00 per calendar day will be imposed for late completion of the contract works”.<sup>5</sup> Commonly featured in the main contract, this has the effect of encouraging the main contractor to complete works on time and prevent delays. Further, the employer can avoid spending time and effort in quantifying the losses.<sup>6</sup> The amount of LDs represents a pre-estimate of the loss that the employer may suffer due to the delay in works, and will vary according to the scale of the project.<sup>7</sup>

6 Consequently, the main contractor may also incorporate LD clauses into subcontracts. These LD clauses that feature in subcontracts are sometimes termed as “flow-down” clauses as they pass the responsibility to pay LDs down the chain of responsibility to the subcontractor.<sup>8</sup> This insures the main contractor against LDs payable to the employer if a subcontractor is responsible for any delays in completion.

### B. *Subcontractors’ liability for liquidated damages*

7 Understandably, subcontractors do not have substantial bargaining power as compared to larger main contractors with more resources. To secure building contracts, subcontractors are more likely to jump at an offer, rather than bicker over terms and conditions, or resist the inclusion of a LD clause in the subcontract. If they do resist, given the competition in the market, other subcontractors may jump in to offer their services instead. Nonetheless, subcontractors should negotiate a fair rate of LDs that

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<sup>4</sup> Andrew Phang, *The Law of Contract in Singapore* (Singapore Academy Publishing, 2012) at para 20.054.

<sup>5</sup> *Multiplex Construction Pty Ltd v Sintal Enterprise Pte Ltd* [2005] 2 SLR(R) 530 at [11].

<sup>6</sup> Chow Kok Fong, *Law and practice of construction contracts* (Sweet & Maxwell Asia, 5<sup>th</sup> Ed., 2018) at para 9.088.

<sup>7</sup> *Ibid.*

<sup>8</sup> Evershed Sutherland, “Going with the flow - the use of “flow-down” clauses in construction subcontracts” (15 October 2015) <[https://www.eversheds-sutherland.com/global/en/what/articles/index.page?ArticleID=en/Construction\\_And\\_Engineering/Construction\\_Going\\_with\\_the\\_flow](https://www.eversheds-sutherland.com/global/en/what/articles/index.page?ArticleID=en/Construction_And_Engineering/Construction_Going_with_the_flow)> (accessed 22 September 2019).

accurately covers the subcontractor's liability for a relevant breach. Subcontractors should also be aware of their potential liabilities arising from LD clauses.

8 For example, in *Nylect Engineering Pte Ltd v BKB Engineering Constructions Pte Ltd*,<sup>9</sup> the court allowed the main contractor's counterclaims against the subcontractor for LDs. The subcontractor failed to complete *crucial* electrical works on time – failing to install necessary electrical power cables and wiring systems.<sup>10</sup> The delays had a “knock-on effect” on the progress of the works of other subcontractors, ultimately delaying the entire project.<sup>11</sup>

9 However, the onus is on the main contractor to demonstrate that the subcontractor is at fault for the delay. The Court of Appeal in *CAA Technologies Pte Ltd v Newcon Builders Pte Ltd* held that the main contractor (Newcon Builders) has to prove that the LDs incurred under the main contract arose *solely* from the breaches by the subcontractor.<sup>12</sup> Even though the subcontractor (CAA Technologies) was unable to show that the delay was caused by another subcontractor, this did not unequivocally show that it was solely responsible.<sup>13</sup> The main contractor had failed to discharge its burden of proof and consequently, its claim for LDs failed.<sup>14</sup> Thus, it is possible for a subcontractor to successfully counter such claims.

### C. *When subcontractors are not liable for liquidated damages*

10 Subcontractors can also attempt to contest LD clauses. Common methods of doing so are:

- (a) arguing that the LD clause is a penalty; or
- (b) arguing that the main contractor prevented the timely completion of works.

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<sup>9</sup> [2004] SGHC 245.

<sup>10</sup> *Id.*, at [30].

<sup>11</sup> *Ibid.*

<sup>12</sup> *CAA Technologies Pte Ltd v Newcon Builders Pte Ltd* [2017] 2 SLR 940 at [84].

<sup>13</sup> *Id.*, at [85].

<sup>14</sup> *Id.*, at [86].

(1) *Penalty clauses*

11 LDs are meant to be a *genuine pre-estimate* of loss.<sup>15</sup> If a LD clause amounts to a penalty, it will be unenforceable. The reason behind this rule is to protect parties in weaker bargaining positions from manifestly disadvantageous and oppressive terms.<sup>16</sup>

12 The following four guidelines are helpful to distinguish whether a LD clause amounts to a penalty:<sup>17</sup>

- (a) First, the sum stipulated will be a penalty if it is extravagant and unreasonable, as compared to the greatest loss that could have been proved following a breach of contract;
- (b) Second, a LD clause is a penalty if the breach to trigger a claim in LDs is confined to a non-payment of money and provides for payment of a larger sum;
- (c) Third, there is a presumption that a LD clause is a penalty if it stipulates for a single lump sum to be payable on the occurrence of various events of breach, as some of the events may only result in minor damage;
- (d) Fourth, just because the potential consequences of breach makes it impossible to accurately estimate the sum of LDs, it does not mean a LD clause is penal.<sup>18</sup>

(2) *Act of prevention*

13 Next, if the main contractor *prevents* the subcontractor from discharging its contractual obligations, he cannot claim for liquidated damages.<sup>19</sup>

14 An “act of prevention” by the main contractor is essentially any act that prevents, impedes, or otherwise make it more difficult for the subcontractor to complete the works in a timely manner.<sup>20</sup> Common examples of an act of prevention include: failure to give timely possession of the construction site, ordering of extra works, or failure to

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<sup>15</sup> *Xia Zhengyan v Geng Changqing* [2015] 3 SLR 732 at [78].

<sup>16</sup> Goh Yihan and Yip Man, “The English reformulation of the penalty rule: Relevance in Singapore” (2017) 29 SAclJ 247-274 at para 26.

<sup>17</sup> *Seraya Energy Pte Ltd v Denka Advantech Pte Ltd and another suit (YTL PowerSeraya Pte Ltd, third party)* [2019] SGHC 2 at [159]–[178]; see also, *Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd* [1915] AC 79 at 86-89.

<sup>18</sup> *Xia Zhengyan v Geng Changqing*, *supra* n 15.

<sup>19</sup> *Lim Chin San Contractors Pte Ltd v LW Infrastructure Pte Ltd* [2011] 4 SLR 455 at [30]

<sup>20</sup> *Id.*, at [31]; see also Chow Kok Fong, *supra* n 6, at para 9.155.

provide plans and drawings expeditiously.<sup>21</sup> Such acts may prevent the contractor from meeting the contractual deadline for completion.

- 15 When this occurs, what is legally known as the “prevention principle” kicks in. This principle stops the main contractor from insisting that the works must be completed by the contractual deadline – i.e. the original completion date will cease to apply. This is because an obligation to complete works on time is *premised* on the requirement that a subcontractor is not delayed by any “acts of prevention” committed by the main contractor.<sup>22</sup> Otherwise, an unreasonable burden would be imposed on the subcontractor.<sup>23</sup>
- 16 The consequences flowing from an act of prevention will vary depending on whether a valid extension of time (“**EOT**”) is granted.
- (a) When an EOT is granted
- 17 If an EOT clause has been stipulated under the subcontract and granted accordingly, a new completion date will be stipulated. LDs will be payable from the extended date in the event of non-completion. Accordingly, an EOT clause safeguards a main contractor’s right to LDs.<sup>24</sup> Further, many standard form contracts provide for an EOT clause, including the SIA Building Contract 2016,<sup>25</sup> FIDIC Red Book 2017,<sup>26</sup> and PSSCOC 2014.<sup>27</sup>
- (b) When an EOT is not granted
- 18 In the event where an EOT is not granted, this can lead to problems with identifying a specific completion date and accordingly, the application of LD clauses. This is because LDs are calculated according to the length of the delay from the contractual completion date to the date of actual completion. Thus if an EOT is not granted nor stipulated within the subcontract, time is said to be “set at large” – meaning there is no longer a

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<sup>21</sup> Chow Kok Fong, *ibid.*

<sup>22</sup> *Yap Boon Keng Sonny v Pacific Prince International Pte Ltd and another* [2008] SGHC 161 at [34].

<sup>23</sup> *Dodd v Churton* [1897] 1 QB 562 at 566.

<sup>24</sup> *Lian Soon Construction Pte Ltd v Guan Qian Realty Pte Ltd* [1999] 3 SLR(R) 518 at [18].

<sup>25</sup> Clause 23, SIA (Singapore Institute of Architects) Building Contract 2016.

<sup>26</sup> Clause 8.5, FIDIC (International Federation of Consulting Engineers) Conditions of Contract for Construction for Building and Engineering Works Designed by the Employer (2<sup>nd</sup> Ed, 2017).

<sup>27</sup> Clause 14, Public Sector Standard Conditions of Contract for Construction Works 2014 (7<sup>th</sup> Ed, 2014).

completion date from which LDs can run.<sup>28</sup> In such cases, the LD clause will legally be rendered inoperative.<sup>29</sup>

### III. Conclusion

- 19 In sum, subcontractors need to be aware of their potential liability under a LD clause. Often, the main contractor will seek to minimize its liability and pass on contractual obligations onto the subcontractor through a “back-to-back provision” – the subcontract will incorporate all the terms under the main contract, often including LD clauses.<sup>30</sup>
- 20 However, the burden of proof ultimately lies with the main contractor in establishing a valid LD claim. Any evidence which shows that the delay in project completion was not solely attributable to the subcontractor will preclude the main contractor from successfully discharging its burden of proof. Moreover, subcontractors should be aware of penalty clauses and any act of prevention by the main contractor which may aid in invalidating LD clauses.
- 21 Should things go south, subcontractors can consider turning to the Singapore Construction Mediation Centre to resolve their disputes.<sup>31</sup> This is a better option than litigation or arbitration which are often adversarial, costly and lengthy. Instead, mediation provides a conciliatory space for discussions and the relationship between parties will not sour. Furthermore, professional mediators are well acquainted with industry norms and capable in helping parties reach an amicable solution.<sup>32</sup>

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<sup>28</sup> *Lian Soon Construction Pte Ltd v Guan Qian Realty Pte Ltd*, *supra* n 24, at [18]; see also Chow Kok Fong, *supra* n 6, at para 9.156.

<sup>29</sup> *Crescendas Bionics Pte Ltd v Jurong Primewide Pte Ltd* [2019] SGHC 353 at [353].

<sup>30</sup> *GIB Automation Pte Ltd v Deluge Fire Protection (SEA) Pte Ltd* [2007] 2 SLR(R) 918 at [45].

<sup>31</sup> The Straits Times, “New mediation centre to resolve disputes in construction sector launched” (12 March 2019), *supra* n 3.

<sup>32</sup> *Ibid.*