India-CRUX Construction Dispute Causation Series Part IV: Late Materials or Products Delivery

HKA-Link Legal Joint Publication

CRUX is HKA's integrated research program which provides unprecedented insight into the common claim and dispute causation factors for engineering and construction projects on a sectoral and regional basis.

At present, the CRUX database encompasses more than 1,600 projects in 100 countries (including India) representing a total capital expenditure of more than US$2.13 trillion. An interactive dashboard has been developed which allows the user to search by region and sector.

This publication series focuses on the top claim and dispute causative factors, prevalent in the Indian project landscape.

Previously, we have discussed in Part I Change in scope, Part II Access Issues and Part III Unforeseen Physical Conditions. In the remaining parts of the series, HKA together with renowned Indian law firms will present topics on late approvals, design issues, poor subcontractor/supplier management, spurious claims, cashflow and payment issues, and contract management and/or administration failures.

This Part IV of the ten-part series focuses on 'Late Materials or Product Delivery' ("**LMPD**") as CRUX identifies this to be a main cause of claims and disputes on projects and covers potential triggers for LMPD, guidance on how to manage these challenges and legal stance/position under Indian law.

Potential Triggers

On a high-level, triggers for LMPD attributable to the contractor and not falling within the scope of the employer's risk and/or *force majeure* include:

- Place of origin of materials
- Unrealistic execution duration
- Improper scheduling/deviation from a functional schedule
- Poor materials/products estimation
- Delay in placing orders
- Difficult site accessibility
- Materials/products availability during execution
- Failure to satisfy required material/product quality criteria
- Damaged or lost/insufficient materials at delivery
- Poor workmanship resulting in material/product wastage during execution
- Requirement for material/product replacement during execution
- Supplier labour capability and productivity
- Supply chain/logistical issues
- Issues affecting raw material supply
- Market forces (including inflation)

For clarity, LMPD here does not concern itself with delays attributable to the employer, for instance when stemming from employer-nominated subcontractors/suppliers, late approvals attributable to the employer, employer's changes to the specification, employer-free issue materials matters, ambiguity or conflict in specifications and standards or drawings attributable to the employer.

Managing Late Material or Product Delivery

It is crucial to consider the guidance provided below on the Pre-Execution and Execution stages of the project while bearing in mind the above triggers.

Pre-execution stage

The starting point for the contractor at the tender stage is to work closely with the materials/products estimation, supply chain and execution teams, to identify the materials/products requirements.

It is essential to draw up a materials/products risk matrix on a section-specific basis, listing potential supply issues, their maximum impact and mitigation measures in advance. It is vital for costing exercises to fully consider the risks associated with LMPD.

Supplier and supply channel credibility need to be verified during the tendering stage for each project without basing it on previously jointly executed projects. For each material/product, there should be a backup supplier list with prices falling within the acceptable range.

The provisions relating to materials/products approval/testing process, materials/products price escalation, cost adjustment, extension of time and liquidated damages are to be reviewed from the potential LMPD situation.

Execution stage

During execution, the contractor should stay ahead of the curve by identifying potential situations when LMPDs might arise. Interacting regularly with internal supply chain teams involved in other projects, external supply chain personnel involved in the execution of similar projects and competitive suppliers to stay informed of any market changes.

In addition, the contractor needs to ensure their procurement, planning/scheduling and civil/construction teams work in a coordinated fashion.

Despite taking necessary precautions, if the contractor finds itself in the LMPD situation, it needs to assess time and cost impact by engaging appropriate methodologies, which may be contractually mandated or derived from widely accepted industry practice.

In addition to focusing on expediting supply in LMPD situations, the contractor should notify its employer of potential delays, and suggest potential alternatives along with options for resequencing works to mitigate any delays.

The legal position in India

In the event of LMPD solely attributable to the Contractor, there are likely to be contractual and/or legal remedies (under applicable Indian law) available to the employer.

Contractual standpoint

From a contractual standpoint, LMPD is likely to trigger the requirement for the contractor to incur liquidated damages.

Standard form contracts in India used by governmental agencies, such as the National Highway Authority of India ("NHAI") or Central Public Works Department ("CPWD") contractually prescribe liquidated damages payable for contractor attributable LMPD.

Liquidated damages are normally a prescribed percentage of the contract amount (for example 0.1%) applied periodically for the duration of delay (for example calculated on a daily/weekly basis) up to a maximum cap (for example 10%) of the contract amount (i.e., delay cap).

While the contractual right may exist, the imposition of liquidated damages is left to the employer's discretion. While the employer may abstain from imposing liquidated damages at the instant when LMPD occurs, imposition is likely in the event contractor fails to meet a future milestone date and/or completion date due to such LMPD.

The other areas of contractual exposure attributable to LMPD caused by the contractor could include non-receipt of milestone-linked payment(s), employer encashing contractor's bank guarantees, or termination of the contract, subject to the severity of impact caused by LMPD and its collateral effect.

Legal standpoint

Under Indian law, the contractor could potentially be liable for payment of damages when LMPD is attributable to them.

The award of damages for the delay to time for completion is codified under the Indian Contract Act, 1872 ("ICA"), with the damages awarded being aimed at placing a non-defaulting party in the same position if the contract has been performed[1]. The applicability of the award of damages is covered under Section 55 ICA read with Sections 51 to 54 ICA, with damages quantification captured under Sections 73 and 74 ICA, as discussed in detail below:

i) <u>Applicability of Damages (Section 55 ICA)</u>

Section 55 of the ICA provides recourse to the employer and provides compensatory entitlement for fixed-term contracts (time being of essence) or extendable contracts (time not being of essence).

Concerning fixed-term contracts (where provision for liquidated damages and extension of time are absent), LMPD can be construed as a failure by the contractor to perform their delivery obligation within the stipulated

[1] Union of India and Others v Sugauli Sugar Works (P) Ltd., 1976 AIR 1414, 1976 SCR (3) 614

timeframe, resulting in the contract being voidable at the employer's option. However, if the employer accepts belated delivery, the employer is prevented from claiming compensation for any loss occasioned by non-performance within the agreed timeframe, unless when accepting LMPD the contractor was provided notice by the employer of its intention to claim[2].

In any event, the employer is obligated to provide a detailed notice of the breach occasioned by LMPD and provide the contractor time to remedy[3] in case, LMPD results in termination.

In case of the contract being extendable (i.e., normally with provision for liquidated damages and extension of time), the contract would not be voidable in the event of LMPD, however, the employer is likely to have an entitlement for the loss caused.

ii) Quantification of Damages (Section 73 & 74 ICA)

Section 73 of ICA deals with general direct and indirect damages following a breach of contract but disallows damages that are considered remote and indirect. When entering into a contract, if the parties contemplate that losses are likely to arise on account of delay to time for completion, they may under the contract stipulate an agreed sum to be paid by the contractor to the employer (i.e. liquidated damages), either resulting in a delay to time for completion or, in some cases causing delays to intermediate milestones (relevant from the perspective of LMPD).

Section 74 of ICA deals with such liquidated damages, where the measure of damages is regarded as 'reasonable compensation' not exceeding the amount and/or penalty prescribed in the contract for such breach[4]. In situations when the said delay cap has reached its limit, the employer may exercise other rights under the contract for the said breach, including termination. However, the codified law in India does not deal with the aspect of the rights of parties in cases where the delay cap has reached its limit.

If the liquidated damages claimed by the employer are disputed, then the courts have held that proof of actual damage suffered is necessary for the award of damages, unless the same is difficult to be proved[5].

In the event of a breach of a contract containing a 'liquidated damages' clause, the employer is required to establish the factum of loss, i.e., the existence of legal injury or loss occasioned because of the contractor's breach[6].

It is settled law that damage or loss caused is a *sine qua non* (essential condition) for applicability of Section 74 of ICA[7]. The courts have on occasion, taken a liberal approach, especially in situations where in contracts, proof of actual loss is extremely difficult to prove. Where the liquidated damages clause in the contract does not provide an estimate/percentage of liquidated damages to be recovered periodically but provides an upper limit, it has been held that *"the Court has to proceed on guesswork as to the quantum of compensation to be allowed in a given circumstance"*[8].

Conclusion

From a practical/executory standpoint, LMPD attributable to contractors could potentially result in non-achievement of project milestones, non-receipt of linked payments and disrupt cash flow. This is in addition to contractual and legal liability that may ensue.

Materials/products serve as the vital lifeline to bring a construction project to fruition. A specific material/product may serve as the most crucial (for instance, panels in a solar power project) or there may be diversified (for instance, concrete aggregates and rebars in an elevated corridor/metro project). In addition,

[2] General Manager, Northern Railway and Another v Sarvesh Chopra, (2002) 4 SCC 45
[3] Indian Oil Corporation vs Lloyds Steel Industries, 2007 SCC OnLine Del 1169
[4] Fateh Chand vs Balkishan Das (1964) 1 SCR 515
[5] Kailash Nath Associates vs Delhi Development Authority and Another (2015) 4 SCC 136
[6] Ibid.
[7] Ibid.
[8] M/s Construction and Design Services vs Delhi Development Authority (2015) 14 SCC 263

the sequence of material/product requirements for the project and their quantities are likely to have a bearing on the supply chain.

Considering this, the contractor is likely to benefit by being proactive in the management of supply chain risks and deploying active risk management.

Contact details

Anand Udayakumar
Consultant, HKA
anandudayakumar@hka.com

Ravi Varma
Partner, Link Legal
ravi@linklegal.in

Jayshree Dugar
Senior Associate, Link Legal
jayshree.dugar@linklegal.in