Practice Guidance Note on Breach of Contract by Clients – Liquidated Damages and Late Payment

Introduction

1. Security Agencies ("**SAs**") provide outsourced security services to clients. The relationship between SAs and clients is normally set out and governed by a service agreement (the "**Contract**").

2. The Committee notes that there is widespread practice of clients and managing agents ("**MAs**") imposing unenforceable LDs on SAs and making late payments of the contract to SAs. The Security Industry Committee of Practice (the "**Committee**") has issued this Practice Guidance Note to assist SAs in such situations by setting out:

    a. How SAs can identify that there has been a breach of contract under either of these two categories;

    b. Steps that SAs should take to create a fairer contracting environment between themselves and their Clients;

    c. Practical steps on how to deal with the imposition of illegal or unfair liquidated damages and late payments.

3. This Practice Guidance Note (the "**Note**") is not legal advice. SAs should seek independent legal advice on the content of the Note.

4. This Note should be read with SICOP-01/24 – the Practice Guidance Note on Dispute Resolution for Security Agencies.

Liquidated Damages

5. LDs are pre-determined monetary amounts specified into a contract that act as **compensation** for specific breaches. They are typically used in contracts where it may be difficult to accurately estimate the actual damages that might arise from a breach. This helps to determine the sum a breaching party has to pay to the non-breaching party without having to go through a complex and costly process of providing damages in court.

6. Because LDs are compensatory in nature, they may **only**, through the exchange of a monetary sum, **restore the non-breaching party to a position it would have been if the contract had been performed** according to the contract. **LDs cannot to be used as penalties or to punish the SA, to "control the SA" or to effect or deter certain behaviour**. The non-breaching party should also not enjoy a windfall from the imposition of LDs.

7. It is important to note that **LDs must be fair and reasonable estimates of likely losses arising from a breach**. LDs that are **excessive, or are intended or operate to penalise the non-breaching party** are **liable to be struck down by the courts as unenforceable penalties**. In simple terms, **LDs that are penalties and not compensatory in nature are liable to be struck down**.

8. Furthermore, LDs must also be **clear, precise and specific**. LD clauses that stipulate a general sum to be paid for an undefined breach may also liable to be struck down by the courts.

9. LDs also cannot be used to 'fine' an SA or to act as a deterrent against certain behaviour. Using LDs in such a manner may also cause the LD clauses to be struck down by the courts.

10. If a court strikes down an LD clause, it means that **the sum specified in the LD clause becomes unenforceable. The client will not be able to claim against the SA for the sum stipulated in the Contract**, and the client will instead have to prove the actual damages it has suffered, which can be a lengthy and complex process. If the client had already deducted the purported LD sums from previous payments to be made to the SA, the client will have to return all the said sums to the SA.

11. In the event that an SA successfully challenges a client in court such that LD clauses are struck down by the court, the SA would be able to claim a proportion of its legal fees, interest and other damages from the client.

12. LDs are often effected through the use of credit notes ("**CNs**") issued by the SA in favour of the client. Often, payment to an SA is delayed because the managing agent takes a long period of time to calculate the purported LDs to be imposed on the SA for the forgoing month. Regardless of the reason as to why payment is delayed, failure to pay on time is likely to be a breach of the service agreement by the client, that entitles an SA to terminate the contract and sue for damages (see the later section on Late Payment).

<u>Basis for Striking Down LD Clauses</u>

13. The reasons why the court may strike down LD clauses are as follows:

    a. <u>Unreasonable amount</u>. If the pre-determined amount is **excessive and grossly disproportionate to the actual potential loss suffered, it can be seen as a penalty** designed to punish the breaching party rather than genuine compensation to the non-breaching party. In this regard, it is important to note that the contract price is a reasonable factor for consideration. If the LD is out of proportion to the contract price, it may be considered a penalty and struck down.

    b. <u>Lack of genuine pre-estimate</u>. If the clause **does not reflect a genuine attempt to estimate potential losses**, but rather appears designed to deter breaches through an arbitrary amount, it might be struck down. The courts would enquire as to how

exactly parties calculated the sum, and whether they had considered the actual potential loss when formulating the sum.

c. Unclear and ambiguous clauses. Clauses that are drafted in a **vague, ambiguous[1] or overly broad** manner may raise the court's suspicions of being unenforceable penalties, and may be struck down.

d. Parties' bargaining power. **Unequal bargaining power** may suggest that the clause was imposed unfairly on the party with less bargaining power.

Common Issues Faced by SAs in Relation to LDs

14. Client and managing agent ignorance. Many SA clients as well as managing agents do not understand how LDs operate. Many have the impression that LDs are intended to either shape behaviour (i.e. serve as a deterrence) or to penalise SAs upon the occurrence of certain stipulated happenings. In fact, LDs designed to achieve these objectives may not be enforceable.

15. Lack of bargaining power. Security contracts are typically awarded pursuant to competitive tenders in which the contractual obligations, including the LD clauses are part of the tender. In this regard, there is little room for SAs to negotiate on contractual terms.

16. Ignorance by SAs on how LDs operate. Many SAs believe that if LDs are incorporated into the service agreements that they have signed, that they cannot challenge the LDs when applied. This is incorrect. As a challenge on LDs would be to determine if a clause is illegal in the first place and therefore unenforceable, **it is open to SAs to challenge LDs after the contract has been signed, and even after a contract has been terminated**.

Common LD Clauses Found in Security Contracts that may be Unenforceable

17. SAs should familiarise themselves with types of LD clauses that are likely to be illegal and unenforceable. The most common types are as follows:

a. LD sums that are not proportionate to contract sums may be unenforceable. Take for example a contract in which a client pays the sum of $5,000 for one security officer to be deployed at its site for one month. If the client applies an LD of $300 per day that the agency did not deploy a security officer, it may be a sum disproportionate to the contract sum because the total LD sum that would apply if the agency failed to deploy an officers for a whole month (assuming an average month of 30 days) would be $9,000, which is almost double the contract sum. A better measure of the daily LD sum for shortfall would be a sum closer to the pro-rated value i.e. $5000 divided by 30 days (~$170).

[1] The Security Industry Committee of Practice is a Standing Committee of the Security Association Singapore that addresses and provides guidance on matters relating to the practice of providing physical security in Singapore.

Likewise, in the same scenario, if the client levies an LD of $50 per clocking round, and there are 3 clocking rounds per shift, it may be a disproportionate sum and the question that would arise would be whether clocking is the main or sole duty of the officer for such a high sum *vis-à-vis* the contract sum to be applied as an LD.

b. Vague clauses that apply a single sum or range for breaches that are not specifically defined are likely to be unenforceable. For example, a common clause inserted into service agreements is a "catch all clause" that enables the managing agent to impose a fine of up to $5,000 for any action that the managing agent deems to have caused harm or damage to the client. Likewise, LDs for "failing to obey lawful orders" are likely to be unenforceable because they are so vague that they cannot possibly prescribe a genuine pre-estimate of loss.

c. Clauses intended to act as a deterrent, including clauses that apply incremental LDs without any corresponding increase in loss caused to the client are likely to be unenforceable. For example, clauses that impose LDs on SAs for officers smoking at site or 'fraternising with maids'. Such actions do not cause any conceivable loss to the client and the LD clause is inserted into the contract as a deterrent to shape behaviour. An example of an incremental LD clause that is likely to be unenforceable is one that prescribes an LD of $100 for a first incident, and $200 for a second incident. If the second incident does not cause more loss to the client than the first, and the increase in sum is intended to penalise the SA merely because the incident had happened again, then it is a clause intended to be a deterrent, which is an unenforceable penalty.

d. LDs that have nothing to do with loss at all and are purely penalties are unenforceable. For example, an LD that is imposed on the SA if a security officer carries out an act while on duty for which he is later convicted of a criminal offence. The fact that the officer is convicted does not in and of itself cause loss to the client and therefore it is unlikely that LDs can be imposed on the SA merely for that. However, if that act had caused some loss to the client, then that act could potentially be the subject of a valid LD. The burden would still be on the client that the prescribed LD sum was a genuine pre-estimate of loss.

e. Clauses that penalise SAs for not carrying out an illegal/ proscribed act are unenforceable. For example, LDs applied on an SA because the SA failed to apply a discriminatory policy, like deploying officers of a certain gender or race.

Committee's Guidance

18. The issue of unfair and unenforceable liquidated damages in the security industry has been highlighted by the Security Tripartite Cluster, the Union of Security Employees and the Security Association Singapore on many occasions. Clients and managing agents often

apply LDs willy nilly, without understanding the legal nature of LDs. This results in SAs being paid less than is due to them under the Contract.

19. Furthermore, as the PWM continues to push the cost of security services higher, the Committee is concerned that clients and managing agents may attempt to use LDs to lower the sums to be paid to SAs. In this regard, it is critical that SAs understand their legal rights as regards LDs and vigorously insist on their contractual rights.

20. The Committee's guidance to SAs on the matter of LDs is as follows:

    a. Before commencing with a new client, SAs should scrutinise the proposed service agreement, including the LD clauses, carefully, and seek legal advice if necessary. SAs should propose changes to clauses that are onerous or that they are unable to commit to. In the event that there is no agreement with the client on changes to such clauses, the SA should adjust its quote to take into account the added risk, or decline to take up the contract.

    b. SAs should also manage risk by checking up on potential clients and managing agents prior to taking up a contract. For clients and managing agents that have a reputation for imposing onerous and unfair contractual terms, SAs should work this risk into their contract prices and charge a higher rate. Alternatively, SAs should simply avoid bidding for such contracts if they ascertain that the risk is too high.

    c. In the course of an existing contract, if an SA is confronted with unfair or potentially unenforceable LDs, the SA can take the following steps:

        i. First, the SA should ensure that there is proof of breach for all LDs that a client or managing agent intends to impose on them.

        ii. Second, the SA can agree to make payment for LDs that are proved and that are reasonable. If indeed there was a breach for which the service agreement provides LDs to be paid, then the SA should make compensation for these in accordance with the Contract.

        iii. For LDs that are unreasonable or unenforceable, SAs should try to negotiate with their clients/ managing agents. It would be useful for the SA to tabulate all the LDs that the client/ managing agent is purporting to apply to the SA, together with the SAs response for each purported LD, for example: "No evidence provided" or "Unenforceable penalty clause". SAs can also direct their client or managing agent's attention to this Practice Guidance Note. There is also an abundance of publicly available information, as well as court cases, on how LDs should be applied.

iv. **If clients or managing agents continue to insist on applying the unenforceable LDs, then the SA should consider taking legal action pursuant to the dispute resolution clause provided in the service agreement. SAs can refer to SICOP-1/2024 – Practice Guidance Note on Liquidated Damages for guidance in such circumstances.**

d. **SAs should revisit all of their concluded contracts to determine if there were LDs in those contracts that could be challenged. LDs can be challenged even after the conclusion of a contract, even if credit notes were issued by the SA in relation to those LDs. SAs can seek legal advice on how to recover LDs they had incurred in past contracts. In the event that an LD clause is struck down, the client will have to return to the SA all the sums that had been levied as LDs.**

e. **SAs can send unfair and onerous contracts and tenders to the Security Association Singapore ("SAS") Secretariat (secretariat@sas.org.sg). SAS can take certain actions: engaging the client or managing agent directly, or seeking an opinion on certain clauses from the SAS Counsel, which will be published for all SAs to take note.**

Late Payment

21. Late payment by clients to SAs are another common form of breach in the security industry.

22. Payment clauses typically include the contract sum to be paid, the period in which payment must be made after the SA has issued its invoice to the client and the manner in which payment is to be made. Some clauses also include stipulations for interest for late payments.

23. As payment on time is often the **only substantive obligation of clients to SAs** pursuant to service agreements, a client's failure to pay the correct sum on time would generally be considered a **material breach that entitles the SA to terminate the contract and sue for damages**, including interest on late payment.

Late Payment due to LDs being Finalised

24. It is common practice for clients and managing agents to delay payment due to purported LDs being calculated or negotiated and/or pending a CN to be issued by the SA for the LDs in the foregoing month.

25. For the avoidance of doubt, unless there are specific stipulations in the service agreement, **if a client fails to make payment on time because LDs are being finalised, the client would still be in breach of contract** for failing to meet the payment stipulations in the contract. It is not only a breach of contract, but clearly unreasonable for a client to withhold payment indefinitely for this reason.

26. Clients and managing agents often claim that they are **unable to process payment without a corresponding CN for LDs** for the same month. **This is incorrect**. A CN can be used to **offset future sums to be paid or effected through a direct refund**, meaning that the sum can be deducted from the next month's contract sum or can be refunded in case to the client by the SA once the CN has been issued.

27. As such, **in the event that LDs are being negotiated past a payment deadline, the correct process would be for the client to make payment in accordance with the payment term, and for any LDs to be deducted via CN from the next month's service sum.**

Committee's Guidance

28. The Committee's guidance for SAs facing late payment is as follows:

    a. **SAs run an outsourced manpower business. They are obligated under the Employment Act to make payment to their employees on time. As such, they should make all efforts to collect their contractual sums from clients on time. Clients should cooperate by making payment in accordance with the contractual clauses.**

    b. **Where clients are late in making payment, SAs should exercise reasonable flexibility to encourage clients to make payment in accordance with the Contract. Regardless whether clients are habitually late in making payment, a single failure to make payment on time is in and of itself a material breach that entitles the SA to terminate the contract and take legal action for damages.**

    c. **Where there is interest for late payments stipulated in the contract, SAs should enforce these strictly. Late payment interest is a form of LD that SAs can impose on their clients. After the payment term, SAs are essentially loaning the contract sum to their client and should be entitled to collect interest for the same.**

    d. **SAs should communicate to clients that contract sums for the foregoing month must still be paid on time regardless that LDs are still being calculated or negotiated or it would be a material breach of contract. A CN can be issued for sums to be deducted from the following month or for the SA to reimburse the sum to the client after the CN is issued.**

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Security Industry Committee of Practice

https://www.sas.org.sg/initiative/committee-of-practice/