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Will class struggle ever end: Employer's Claims and Engineer's Determinations under FIDIC - Procedural Pitfalls for Employers and Opportunities for Contractors

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Why construction projects are like a struggle between the classes

"The history of mankind is one of continuous development from the realm of necessity to the realm of freedom. This process is never ending. In any society in which classes exist, class struggle will never end".

Did Chairman Mao work in the construction sector? His words are certainly apt to describe the perennial relationship between Employer and Contractor under construction contracts. Employers expect the outcome of the enterprise to be certain and use the construction contract to apportion risk to achieve the desired result. This is the *"realm of necessity"*. However, the contractor as the working party at the other end of that enterprise, has to deal with all the stuff that happens in delivering the project, the outcome is neither certain nor predictable. The is the *"realm of freedom"*, where fixed outcomes become moveable feasts.

On large and complex projects, the impact of risks during the currency of the works will invariably translate into substantial additional costs. Where that occurs, the parties will often retreat back into the words of the contract to determine who pays what to whom and how much. If the Employer class seeks to impose substantial and inappropriate amounts of risk onto the Contractor class, the fact that there is an ensuing *"class struggle"* should take no one by surprise.

This article concerns some of the machinery under the FIDIC[1] suite of international construction contracts which are designed to process and administer claims by the Employer class against the Contractor class in construction society. Much has been written about the FIDIC provisions for contractors' claims and I do not propose to address that machinery, save for the purpose of comparison with Employer's claims.

The Employer's claim machinery under FIDIC

The rainbow suite of contracts published by FIDIC are so called because they come in a palette of colours.[2] The Employer's claim machinery is well illustrated and broadly similar between the Red, Yellow and Silver Books. As readers will no doubt recall, the Red Book are a set of conditions of contract for building and engineering works designed by the Employer whereas the Yellow Book conditions are for building and engineering works, designed by the contractor.[3] The Silver Book are a set of conditions for contract for EPC Turnkey Projects. In essence, the FIDIC Silver Book is like the Yellow Book but with additional risk allocated to the Contractor. It might be said to be the favourite tool of the Employer ruling class.

1 Fédération Internationale des Ingénieurs - Conseils, which is translated from French as The International Federation of Consulting Engineers.

2 Red (Employer design); Pink (World Bank version of the Red Book); Yellow (Contractor design); Silver (Turnkey); Green (Short Form); Blue (Dredging); Gold (Design, Build, Operate); White (Consultant Appointment) etc.

3 The full title of the Yellow Book is "Conditions of Contract for Plant and Design-Build".

However and as I have said, the Employer's claim machinery under Red, Yellow and Silver Books is broadly similar. The starting point is Sub-Clause 2.5 (Employer's Claims) which states as follows:

> *If the Employer considers himself to be entitled to any payment under any Clause of these Conditions or otherwise in connection with the Contract, and/or to any extension of the Defects Notification Period, the Employer or the Engineer[4] shall give notice and particulars to the Contractor. However, notice is not required for payments due under Sub-Clause 4.19 [Electricity, Water and Gas], under Sub-Clause 4.20 [Employer's Equipment and Free-Issue Material], or for other services requested by the Contractor.*
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> *The notice shall be given as soon as practicable after the Employer became aware of the event or circumstances giving rise to the claim. A notice relating to any extension of the Defects Notification Period shall be given before the expiry of such period.*
>
> *The particulars shall specify the Clause or other basis of the claim, and shall include substantiation of the amount and/or extension to which the Employer considers himself to be entitled in connection with the Contract. The Engineer shall then proceed in accordance with Sub-Clause 3.5 [Determination] to agree or determine (i) the amount (if any) which the Employer is entitled to be paid by the Contractor, and/or (ii) the extension (if any) of the Defects Notification Period in accordance with Sub-Clause 11.3 [Extension of Defects Notification Period].*
>
> *This amount may be included as a deduction in the Contract Price and Payment Certificates. The Employer shall only be entitled to set off against or make any deduction from an amount certified in a Payment Certificate, or to otherwise claim against the Contractor, in accordance with this Sub-Clause.*

As will be noted, FIDIC General Conditions are numbered but only to two levels; after that, any further sub-paragraphs are unnumbered but it is often said that FIDIC is drafted by engineers for engineers (not for pedantic lawyers like me). Anyway, there are quite a lot of words to digest in Sub-Clause 2.5 but in essence it means that if the Employer feels a claim coming on, it *"shall give notice and particulars to the Contractor"*. This is the first point to note about Employer's claims; the Employer should not hold back. Indeed, it is required to assert by giving notice and provide particulars of its claim. If it fails to do so then technically speaking, the Employer will be in breach. Although the Contractor's loss from that breach may be difficult to discern, it might mean that the Contractor is denied the opportunity to take steps to mitigate its loss that arises from the eventual claim, when belatedly asserted by the Employer.

Estoppel arguments

There is another risk for Employers and potential opportunity for Contractors. Under English and other common law jurisdictions, estoppel by convention can arise when parties to a contract act on an assumed, communicated and shared state of fact or law. The party claiming the benefit of the convention must have relied on or been materially influenced by the common assumption (although both parties will almost invariably have relied upon it) and a key element will be unconscionability or unjustness on the part of the person said to be estopped. It can only be used as a shield and not a sword and analysis is required to ascertain in which way it is being used. However, once the common assumption is seen to be wrong, estoppel by convention can come to an end. Thus, if in the currency of the project there are claims which the Employer considers itself to be entitled to for payment from the contractor but it does not (in breach of Sub-Clause 2.5) give notice and particulars to the Contractor, that course of conduct may establish a convention on which the Contractor can rely.

It might be that the parties are collaborating at site level, addressing challenges to the project as these present themselves and working through those challenges with agreed and shared solutions. In that situation, a new form of working or convention may be established where the parties adopt a different code of conduct from that set out in the contract. That alternative way of working will most likely be driven by the necessity of ensuring a successful completion of the project. Parties might even agree payments against different milestones from those under the original contract. All this can establish an estoppel by convention. Of course, those Employers who are experienced or have the right advice will document any material changes and make sure these are recorded as agreed deeds of variation to the terms of the contract if there is indeed the necessity to depart from the

4 This wording differs as there is no independent Engineer; the Employer administers the contract provisions itself albeit through an Employer's Representative. Thus, under Sub-Clause 2.5 of the Silver Book, it is simply the Employer who gives notice and particulars to the Contractor.

contract terms. In this way, such Employers ensure there remains in place a documented code that regulates and governs the parties' rights and obligations. However, where the changes in behaviour and conduct are not documented but become a matter of established convention, then we enter the realm of freedom.

Different standards for different classes

The second point that may be noted about Sub-Clause 2.5 is that the notice of the claim *"shall be given as soon as practicable after the Employer became aware of the event or circumstances giving rise to the claim"*. This is to be contrasted with Sub-Clause 20.1 of FIDIC (Contractor's Claims) where there is a longstop date for the giving of a notice of claim being *"not later than 28 days after the Contractor became aware, or should have become aware, of the event or circumstance"* giving rise to the claim. Thus, the Employer has (arguably) more leeway in terms of the time to give notice of its claims and is not subject to any express consequences if it fails to comply.[5]

It is also to be noted that not only must the Employer give notice of a claim but it must also provide particulars. As to what those particulars should be, FIDIC simply says that these *"shall specify the clause or other basis of the claim, and shall include substantiation of the amount and/or extension to which the Employer considers himself to be entitled in connection with the contract"*. This is to be compared with the language in Sub-Clause 20.1, applicable to Contractor's claims, where the Contractor is required to provide supporting particulars and to keep *"such contemporary records as may be necessary to substantiate the claim"*. The meaning and impact of those words (which also appeared in the previous edition of the FIDIC Red Book contract) were considered by the Supreme Court of the Falkland Islands in the case of *Attorney General for the Falklands v Gordon Forbes* (1993).[6] As such, this case has persuasive weight before an English Court and would have similar significance in other common law jurisdictions.

The Court found that *"contemporary records"* in this context means records produced or prepared at the time of the event in question, whether by the Contractor or the Employer. Conversely and significantly, contemporary records do not include witness statement evidence produced after the events in question. Thus, to the extent that Contractors' claims under FIDIC depend on witness statement evidence which is not supported by contemporaneous records, that claim will fail.

When it comes to looking at the claims machinery under FIDIC, the rules applicable to the Contractor class appear to be a lot more strict than those to which the ruling Employer class assume. Such may be said to reflect the relative bargaining power of the parties; much will depend on the economic environment in which the construction contract is awarded. If one were to chart those projects which were commenced in the aftermath of the post-Lehman financial crisis,[7] it is possible to see a contraction in macro economic activity across many parts of the globe.[8] In the construction sector, this became characterised in the years around 2009 to 2011, by too much capacity chasing too little work. The result of that imbalance is hard for Employers and their financiers to resist lower prices and harder contract terms. As these same projects are coming through to completion in 2015, the class struggle continues unabated as few Contractors are willing to take a significant hit to their balance sheet.

5 But see now Privy Council judgment in *NH International v National Insurance Property Development Co Ltd* [2015] UKPC 37, a judgment of the Privy Council which in effect treats compliance with Sub-Clause 2.5 as a condition precedent to an Employer's entitlement to pursue cross claims and set offs against the Contractor.

6 [2003] BLR 280.

7 In September 2008, Lehman Brothers, Wall Street's fourth-largest financial institution at the time, announced that it was filing for Chapter 11 bankruptcy protection. This had a catastrophic knock on effect for global financial markets.

8 With some exceptions, such as Canada which continued to ride the commodities 'super cycle' boom fuelled by China's insatiable appetite for industrial and urban expansion. That strength of that demand has abated in recent years, leading to a collapse in commodity prices and over contracting capacity in mining and related sectors.

Determinations of Employer's claims

This brings me to a unique feature of the FIDIC claims machinery. This is a provision which may strike many readers as odd. Sub-Clause 3.5 (Determinations) states:

> *Whenever these Conditions provide that the Engineer shall proceed in accordance with this Sub-Clause 3.5 to agree or determine any matter, the Engineer shall consult with each Party in an endeavour to reach agreement. If agreement is not achieved, the Engineer shall make a fair determination in accordance with the Contract, taking due regard of all relevant circumstances.*
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> *The Engineer shall give notice to both Parties of each agreement or determination, with supporting particulars. Each Party shall give effect to each agreement or determination unless and until revised under Clause 20* [*Claims, Disputes and Arbitration*].

The only person between the Employer being both as judge and jury in its own court is the Engineer. That is a point of some significance which is addressed below, but the point is at its most extreme under FIDIC Silver Book terms. Here, there is no Engineer, only an Employer's Representative. In terms of the turnkey nature of the Silver Book, this is conceptually correct; the Contractor is responsible for completing the design and construction of the works and there is no need for an independent Engineer to police compliance with the design as long as the Employer's desired turnkey solution is delivered at the end of the process.

However, this creates the potential for a less than impartial Determination process under FIDIC Silver as the references in Sub-Clause 3.5 to the Engineer are replaced by the Employer. This may strike many as creating an irreconcilable conflict of interest on the part of the Employer. Consider the scenario where the Employer decides that it has a claim against the Contractor and gives notice of that claim. This triggers operation of the Determination machinery in Sub-Clause 3.5. The Contractor is then required to agree the Employer's claim but on the perhaps fair assumption that such agreement is not achieved, the Employer is then empowered to make a Determination. It is perhaps also fair to assume that such a Determination will be in favour of its own claim. That may be said to create a conflict of interest and would certainly be enough to cause Chairman Mao to start thinking about a revolution.

Role of the Engineer

Under FIDIC Red and Yellow Books, the position is ameliorated by the role of the Engineer. Under English and other common law jurisdictions, there is a well developed corpus of law concerning the exercise an Engineer's that involves determining the entitlement of Contractors' entitlements. Although the Engineer is engaged and paid by the Employer to perform this role under the construction contract, he is required to exercise his discretion independently, in an unbiased manner and fairly. As was said in the House of Lords' case of *Sutcliffe v Thackrah* (1974)[9]: *"He is not employed by the owner to be unfair to the contractor."*

However, in civil law jurisdictions, the independent role of the certifying Engineer does not have the same level of recognition. Parties do not regard the Engineer as neutral in such matters but more as the hired gun of the Employer. This reflects the commercial reality of the situation. As Lord Hoffmann observed in *Beaufort Developments Ltd v Gilbert Ash NI Ltd* (1999)[10] *"... the architect is the agent of the employer. He is a professional man but can hardly be called independent"*. There is of course a distinction between being independent and impartial. Even where the Engineer is engaged as Employer's Representative on behalf of the Employer and where the Engineer may have a commercial interest in the Employer through a project company shareholding, he is (under English law and common law jurisdictions at least) likely to have a duty to act impartially and not to prefer his own interests over those of the Contractor.

In the context of the FIDIC Silver Book, it may be suggested that this applies to the role performed by the Employer itself under Sub-Clause 3.5, when making a Determination as to its own claims.

9 [1974] AC 727.
10 [1999] AC 266.

This is well illustrated by the case of *Costain Ltd v Bechtel Ltd* (2005),[11] a decision of Jackson J in the English Technology and Construction Court. The Contractor on the Channel Tunnel High-Speed Rail Link Project applied for interim injunctions to prevent interference in the process of contract administration, specifically in deciding on Contractor's claims. Under the construction contract, the Project Manager had responsibility for determining how much the Contractor should be paid. However, the Project Manager was a consortium of which Bechtel was the major shareholder and with a financial interest in the outturn cost of the Project. At an emergency meeting of the project management team concerning budget overruns, an employee of Bechtel and the Executive Chairman of the Project Manager consortium, addressed the staff involved in determining what was due to the Contractor. In effect, he advocated a policy that would have the effect of denying the Contractor its due entitlements. One of the questions before the judge was *"When assessing sums payable to (the contractors) … is it (the contract administrators') duty (a) to act impartially as between employer and contractor or (b) to act in the interests of the employer?"* Mr. Justice Jackson observed at the outset that this issue *"has significance extending beyond the boundaries of the present litigation"*.

Whilst these were injunction proceedings that did not require an authoritative determination of the parties' rights and obligations, the significance of the Court's comments as to the exercise of the Project Manager's judgment are illuminating: *"It would be a most unusual basis for any building contract to postulate that every doubt shall be resolved in favour of the employer and every discretion shall be exercised against the contractor."*

Could it therefore not be said that even where the Employer is judge and jury in its own court under FIDIC Silver Book terms, that when making a determination of its claim against the Contractor, the Employer must nevertheless have a duty to act impartially and fairly. If that is right and if the Employer fails to act as required, the key question then arises as to whether this renders the Employer's Determination as invalid and of no effect.

Some commentators will say no; pointing out that the contract provides a dispute resolution process designed to answer just that question. However, two points can be made as to that. First, the Court in the *Costain* case did not accept the argument that the inclusion of a dispute resolution procedure militated against the existence of a duty on the Project Manager to act impartially in matters of certification, enabling the Court to intervene. Virtually every construction contract has such provisions and FIDIC is no exception. Second, even where the role of the Engineer is replaced with that of the Employer's Representative and there is no recourse to a dispute resolution process, the common law approach would allow a tribunal to grant appropriate relief to the Contractor if and to the extent it proves breach of contract by the Employer.[12]

The difference between Sub-Clause 3.5 Determinations under the FIDIC Silver Book on the one hand and Red and Yellow Books on the other, may therefore be less extreme than first appears. That said, the argument as to due process based on duties of impartiality is certainly an easier argument to run under Red or Yellow Books than under the Silver Book, given the express role of the Engineer.

It is also worth noting that if the Employer has decided to procure its works using the FIDIC forms, it may have engaged the Engineer under FIDIC White Book terms. These terms provide that where the Engineer is appointed to exercise powers or duties under the construction contract between Employer and Contractor, it may[13] *"act fairly … as an independent professional exercising his judgment with reasonable skill, care and diligence"*. In any event, Sub-Clause 3.5 expressly contemplates *"a fair determination in accordance with the Contract, taking due regard of all relevant circumstances"*.

Thus, and even in civil law jurisdictions, where projects use the FIDIC suite of contracts, arguments based on English common law concepts may find a resonance via the application of the contract terms.

11 [2005] EWHC 1018.

12 See Court of Appeal's decision in *Balfour Beatty Civil Engineering Ltd v Docklands Light Railway Ltd* [1996] 78 BLR 42 but note the later House of Lords' decision in *Beaufort Developments Ltd v Gilbert Ash NI Ltd* (1999) where Lord Hoffmann doubted the correctness of the *Docklands Light Railway* case, insofar as it held the determination of the Employer's Representative to be conclusive and not open to challenge.

13 This is from the 4th edition (2006) of the White Book. The 3rd edition had used the word "shall" but the 4th edition drafting committee decided it was better to be less prescriptive.

Consultation is important

However, another important feature of the Sub-Clause 3.5 Determination process is that it requires the Engineer to *"consult with each Party in an endeavour to reach agreement"*. The Engineer is not there to rubber-stamp the Employer's claims.

Consultation connotes a process of seeking views and considering those views. No time limit is set within Sub-Clause 3.5 for the process of consultation to run its course. It is suggested that the process should (if properly discharged) take such time as is appropriate, in all the circumstances. This may be a longer period for claims which are large and complex and correspondingly shorter for small or more straight forward claims. It may also involve more than a single exchange of views and submissions. After all, the Engineer is to *"endeavour"*. This requires action; lip service will not suffice.

If the Employer makes submissions to the Engineer as part of the consultation process with which the Contractor disagrees and is able to better inform the Engineer, the process should admit of a further round of submissions. Fairness means giving each party an opportunity to state its case and respond to the case of the other. Sub-Clause 1.3 of FIDIC provides that *"determinations ... shall not be unreasonably withheld or delayed"* but what is reasonable depends on all the circumstances.

Again, if the Engineer under FIDIC Red and Yellow (and arguably the Employer under FIDIC Silver) fails to properly discharge the duty to *"consult"* under Sub-Clause 3.5, it opens itself up to the argument that any resulting Determination is non-compliant with the machinery of the contract and as such is invalid and of no effect. In the writer's experience, many Engineers and Employer's Representatives under FIDIC forms give insufficient attention to the importance of following due process under the Determination machinery. That can be a pitfall for the Employer and an opportunity for the Contractor.

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