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Article

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Employer's financial arrangements and claims under FIDIC forms of contract

Introduction

We live in challenging times. The fall in commodity prices and geopolitical risks (including the Brexit)[1] combine to create strong head winds affecting business confidence and the appetite to invest in the development of long term assets. Working against these head winds is the relentless march of urbanisation and associated industrialisation, particularly in emerging economies eager to develop and improve the living conditions of their citizens.[2] The global trend of urbanisation creates a need for large scale investment in infrastructure on an international scale, be it power generation assets,[3] transport, water treatment facilities, sea ports or airports, all of which require the construction of physical assets.

It is perhaps an obvious point but delivery of the built asset will require a contract to regulate its provision. The construction contract will be used to specify the design and performance characteristics of the asset as well as containing provisions to regulate how the cost and time to complete are to be calculated and assessed. The contract can be (and in many cases is) drafted as a bespoke instrument, crafted for the particular project required. However, there is a considerable attraction to standard form contracts; both repeat and one-off clients may feel more comfortable with a standard form and such forms are also familiar to the supply side of the market.

The FIDIC forms of construction contract are amongst the most widely used of standard form contracts used internationally[4]. FIDIC contracts started out life with a focus on the European market and initially, with a focus on civil engineering projects. Nowadays, FIDIC contracts are promoted globally and encountered in many jurisdictions beyond Europe, including South America, China, the Far East and Africa and in sectors from civil engineering infrastructure to process engineering and power generation.

Disputes in commercial relationships are an inevitable fact of life. However, when there are economic tensions between those procuring assets and those supplying them, the likelihood of disputes arising increases. These tensions are prevalent in the international market currently, due to the cancellation or postponement of billions of dollars of projects by major oil and mining companies, in reaction to the price downturn in oil and commodities

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1 British Exit from the European Union.

2 Raising global growth to deliver better living standards and quality jobs has been the G20's highest priority over the past year, with the "Global Infrastructure Initiative". However, this has identified a funding gap in infrastructure investment of around USD 15 to 20 trillion over the next 15 years.

3 Two out of three people in subSaharan Africa lack access to electricity. Tony Blair's Africa Governance Initiative is working with President Obama's Power Africa initiative to help drive access to electricity across the continent.

4 There are other standard form contracts used internationally including those prepared by the Engineering Advancement Association of Japan ("ENNA"); the Institution of Chemical Engineers ("IChemE"); the Institutions of Mechanical Engineers and Engineering & Technology ("IMechE"); and the New Engineering Contract ("NEC").

and in many cases, the need to re-build balance sheets. This has led to significant over-capacity on the contracting side in many international markets, with too many contractors chasing too little work. This imbalance between supply and demand has the tendency to produce contractors tendering for works at costs which are barely economic, with the sole purpose of supporting the continued existence of the contracting organisation. This mentality can also lead to contractors seeking to make up for their loss-making or slender margins through the advancement of claims. Under-funded Contractors can cause significant problems to Employers developing their assets. Taken together, this produces a potent cocktail of problems and disputes.

FIDIC forms of contract recognise disputes and claims as a fact of life and they are unique amongst standard form construction contracts, in containing set procedures for the administration of claims by one party against the other. Much has been written about claims made by contractors under the FIDIC forms (given the strict claims machinery of Sub-Clause 20.1) but until recently, not much attention appears to have been focused on the administration of Employers' claims. This brief article seeks to redress that balance and to do so in light of a recent and important Court decision.

This is a decision of the Judicial Committee of the Privy Council and it also addressed the provision of security for payment by the Employer; another unique feature of FIDIC. It is therefore important for parties using FIDIC forms of construction contract internationally for the development of their infrastructure, process and energy plants.

The Judicial Committee of the Privy Council

The Judicial Committee of the Privy Council originated as the highest court of civil and criminal appeal for the British Empire. It now fulfils the same purpose for many current and former Commonwealth countries, as well as the United Kingdom's overseas territories, Crown dependencies and military sovereign base areas. The most common work of the Court is the hearing of Commonwealth appeals, typically from the Court of Appeal of various jurisdictions in the Caribbean and West Indies[5] as well as Jersey, Gibraltar, Mauritius and New Zealand. A judgment of the Privy Council is made by Judges who sit on the UK's Supreme Court.

One third of the world's population live in common law countries and because of the system of precedent, the decisions of the Privy Council on appeal from one common law jurisdiction, will be relevant when considering similar legal questions in all other common law jurisdictions. A judgment handed down by the Privy Council is therefore an important judicial pronouncement; it is binding in the jurisdiction to which it relates and has persuasive authority in all other common law jurisdictions, including England, Wales and Northern Ireland.

It is therefore significant when the Privy Council comes to consider both the Employer claims machinery and the provisions concerning Employer's financial arrangements of the widely used FIDIC form of contract as it did in 2015. This is particularly so given that these two provisions of the FIDIC form had not been considered judicially before and the Privy Council is such a senior court.

5 Antigua and Barbuda, Anguilla, the Bahamas, Belize, Bermuda, the British Virgin Islands, the Cayman Islands, Jamaica, Montserrat, St Christopher and Nevis, Trinidad and Tobago, Turks and Caicos Islands.

EMPLOYER'S FINANCIAL ARRANGEMENTS AND CLAIMS UNDER FIDIC FORMS OF CONTRACT

The *NIPDEC* case

The case of *NI International (Caribbean) Limited v National Insurance Property Development Company Limited* (No. 2) (2015)[6] is a judgment of the Privy Council, on appeal from a decision of the Court of Appeal of the Republic of Trinidad and Tobago. The judgment was delivered by Lord Neuberger (who also serves as President of the UK's Supreme Court) in a judgment handed down on 6 August 2015. The case concerns disputes between the Employer (NIPDEC) and the Contractor (NHIC) arising out of a contract for the construction of the new Scarborough Hospital in Tobago. The contract was based upon the FIDIC General Conditions of Contract for Construction, First Edition 1999, also known as the Red Book. The terms of the Red Book as considered by the Court in the *NIPDEC* case are identical to those found in the FIDIC Yellow and Silver Books.[7] This decision is therefore of widespread application for international projects which use FIDIC Red, Yellow or Silver Book terms as the basis of the construction contract.

Following disagreements between the parties, NHIC suspended works on the project and some time later purported to exercise its right to determine the contract. The parties then referred a number of differences to arbitration under the terms of the contract. The Arbitrator (Dr Robert Gaitskell QC) issued a number of awards. Two of the issues determined by the Arbitrator were then challenged. These two issues were connected.

The first issue was the Arbitrator's decision that the Contractor, NHIC, was entitled to terminate the contract. This arose from a question as to whether the Employer, NIPDEC, had met the threshold for giving financial security for performance of its payment obligations under the contract (Issue No.1). The second aspect of the Arbitrator's award which was challenged related to certain financial claims which he had to resolve. This concerned the requirements for NIPDEC to commence and maintain its claims against the Contractor (Issue No.2). It may be convenient to address each issue in turn.

Employer's financial arrangements – a mixed question of fact and law (Issue No.1)

As noted earlier, FIDIC is unique amongst standard form international construction contracts in containing a provision requiring the Employer to provide satisfactory evidence that it is able to discharge its payment obligations under the contract. Sub-Clause 2.4 states:

> *"The Employer shall submit within 28 days after receiving any request from the Contractor, reasonable evidence that financial arrangements have been made and are being maintained which will enable the Employer to pay the Contract Price (as estimated at that time) in accordance with Clause 14 [Contract Price and Payment] …"*

The facts in the *NIPDEC* case works provide a salutary lesson in the application of this provision and the effect of non-compliance. The works commenced in March 2003 and were subject to an original Contract Price of some TT$118,185,069.[8] As they progressed, the cost of the works increased and in September 2014, the Contractor requested that the Employer provide evidence of its financial arrangements under Sub-Clause 2.4 sufficient to satisfy the projected increased Contract Price, which was estimated to be in excess of TT$286 million;[9] an increase of over 140%.

6 [2015] UK PC 37.

7 Yellow Book *Conditions of Contract for Plant and Design-Build* (ISBN 2-88432-023-7) and Silver Book *Conditions of Contract for EPC/Turnkey Projects* (ISBN 2-88432-021-0), both First Editions, 1999.

8 Approximately US$ 17.6m.

9 Approximately US$ 42.6m.

EMPLOYER'S FINANCIAL ARRANGEMENTS AND CLAIMS UNDER FIDIC FORMS OF CONTRACT

The Privy Council judgment gives outline facts as to the extent to which the Employer sought to satisfy the evidential threshold under Sub-Clause 2.4. For the full story, you need to go to the Trinidad and Tobago Court of Appeal judgment.[10] The Court of Appeal judgment was delivered on 20 December 2013 and sets out the text of the relevant exchange of letters between the parties and the financial security assurances given by the Office of the Permanent Secretary of the relevant Ministry. It is not necessary to recite the full exchanges between the parties but it is sufficient to note that the Contractor was concerned that without formal Cabinet Approval from the Government of Trinidad and Tobago, any assurances would be of limited value.

In approaching this question, the Court of Appeal found that "*reasonable evidence*" of financial arrangements under Sub-Clause 2.4 was a mixed question of law and fact, quoting *Hudson's Building and Engineering Contracts*[11]:

> *"... it has long been recognised that some questions of law depend upon applying what have been called primary facts to a legal proposition itself containing a factual element ... sometimes described as a question of mixed law and fact or simply as a secondary finding of fact. Classical examples would be a finding that, on primary facts found, a contract had been frustrated or that a particular period constituted a reasonable time within which service of required notice was to take place."*[12]

However and crucially, the Court of Appeal allowed itself to get involved in the factual aspect of the question:

> *"Similarly, in this case the assessment of the evidence is a question of fact. Whether that evidence is "reasonable" is a question of law. It is an objective standard. Since it is an objective test, it is reviewable by a Court of law. Moreover, in applying the law to the facts any wrongful conclusion or wrongful inference of fact is also reviewable as an error of law."*[13]

One might, as a first impression, conclude that there was nothing wrong with the Court of Appeal reviewing the facts afresh. After all, that was what the appellant Employer was asking the Court of Appeal to do, in deciding whether the Employer had in fact satisfied the "*reasonable evidence*" threshold of financial arrangements under Sub-Clause 2.4. On this basis, the Court of Appeal reasoned that the Arbitrator had been wrong to conclude on the evidence that the lack of formal Cabinet approval of the increased budget for the works did not satisfy the threshold of "*reasonable evidence*" of financial arrangements under Sub-Clause 2.4. In the judgment and reasoning of the Court of Appeal:

> *Clause 2.4 speaks of "reasonable" evidence. It does not require the best or purest form of evidence. Reasonableness for the purposes of clause 2.4 depends on the nature of the evidence. Cabinet approval is no doubt the best form of evidence of financial arrangements. Thus the evidence of Cabinet approval would easily have satisfied the requirement of "reasonable" evidence in clause 2.4, as did the December 2004 letter. But the absence of Cabinet approval would not necessarily have breached it, if the assurance of the Employer's ability to pay came from the Permanent Secretary. The lack of Cabinet approval does not render any other evidence "not reasonable". That must turn on the nature of the evidence. NHIC by its insistence on Cabinet approval was asking, not for reasonable evidence, but for an absolute guarantee or assurance of payment. I struggle to comprehend how the letters of the Permanent Secretary can be regarded as anything but reasonable evidence and to such an extent that an entire project is shut down by a private contractor after millions of dollars of public funds have been spent."*[14]

10 C.A. No. 281 of 2008. H.C.C. No. CV2007-02224.
11 Volume 2, 11th Edition.
12 Paragraph 80 CA judgment.
13 Paragraph 81 CA judgment.
14 Paragraph 91 CA judgment.

However, this was an appeal against the decision of an Arbitrator. This was found by the Privy Council to be a critical factor and fatal to the integrity of the Court of Appeal's judgment because its approach involved substituting the Court's judgment for that of the Arbitrator on a matter which was pre-eminently for the Arbitrator to determine. The Privy Council found that the Court of Appeal had allowed itself to take over the fact-finding role of the Arbitrator, which was something it was not permitted to do.

NIPDEC is therefore a good illustration of the Court's policy to upholding arbitral awards. Where the parties agree to refer their disputes to the decision of an Arbitrator, they do so to the exclusion of the Court. Only in limited circumstances, is it permissible to overturn an Arbitrator's award. However, in the *NIPDEC* case, the Privy Council found that there was no basis for interfering:

> *"Where parties choose to resolve their disputes through the medium of arbitration, it has been long established that the courts should respect their choice and properly recognise that the arbitrator's findings of fact, assessments of evidence and formations of judgment should be respected unless they can be shown to be unsupportable"*[15].

Impact of the Privy Council decision in *NIPDEC* (Issue No.1)

The effect of the Privy Council decision on Issue No.1 (*Employer's financial arrangements*) was that the Arbitrator's award stood undisturbed, in determining that the Employer had failed to satisfy the threshold of "*reasonable evidence*" of satisfactory financial arrangements under Sub-Clause 2.4. This was important because non-compliance by the Employer with its obligations under Sub-Clause 2.4 gave rise to the right of suspension (Sub-Clause 16.1) and termination (Sub-Clause 16.2) by the Contractor.

On this basis, the Contractor had been entitled initially to suspend and ultimately to terminate the contract by reason of the Employer's breach.

As a result of the decision in *NIPDEC*, it is likely that the issue of "*Employer's financial arrangements*" under Sub-Clause 2.4 of FIDIC will receive a greater focus from parties on both sides of the contract. Contractors will want to retain the provision, as it provides a valuable protection to the effect that it will be paid for its endeavours and, if "*reasonable evidence*" of satisfactory financial arrangements is not forthcoming, the Contractor can suspend or terminate. This is a powerful tool in the hands of the Contractor, which is also found in the FIDIC Yellow and Silver Books. It is also a tool that can be used throughout the currency of the project, whenever the Contract Price appears likely to be subject to a material increase. In this regard, the final sentence of Sub-Clause 2.4 is worth noting. This states:

> *"If the Employer intends to make any material change to his financial arrangements, the Employer shall give notice to the Contractor with detailed particulars."*

This means that where the financial circumstances the Employer or economic conditions change during the construction execution phase, necessitating a need to re-negotiate terms with its lenders, joint venture partners or off-takers (for instance) this may well constitute "*any material change to his financial arrangements.*" In these circumstances, the Employer must notify the Contractor and if the Contractor is concerned, it can then trigger the requirement in the first part of Sub-Clause 2.4 and require the Employer to provide "*reasonable evidence that financial arrangements have been made and are being maintained which will enable the Employer to pay the Contract Price.*"

15 *NIPDEC* judgment of Privy Council at paragraph 29.

The *NIPDEC* decision may also cast doubt as to the bankability of certain projects which use the FIDIC form of contract for the construction execution phase but which are dependent on third party finance. If the debt service cover ratio is impaired due to the fall in the price of the commodity being processed for sale by the plant or there has been a major cost blow-out (the latter being the case in the *NIPDEC* case), the project sponsor may find itself bound to notify the Contractor of material change in its financial arrangements. If the Employer is then unable to provide "*reasonable evidence*" of satisfactory financial arrangements, the Contractor can suspend or terminate. Where the project is still in the execution phase, this would leave Lenders on a project financed transaction with little choice but to step-in and complete the project themselves. Lenders may baulk at the prospect of that risk.

Accordingly, it may be expected that Employers using FIDIC forms will look to amend or remove the provisions of Sub-Clause 2.4 altogether. The FIDIC Guide has this to say on the subject:

> *"If the Employer anticipates that (because of the Contract's duration, for example) he will not be able to submit evidence in respect of the whole Contract Price, he would presumably have limited his obligations by an appropriate amendment in the Particular Conditions."*16

What that amendment may be is, of course, a matter for the Employer to determine and ultimately will be an issue to agree or negotiate with the Contractor.

It should be noted that the FIDIC Gold Book[17] differs from the Red, Yellow and Silver Books on this issue and points to one alternative. Sub-Clause 2.4 of the Gold Book (*Employer's financial arrangements*) provides that such arrangements are to be detailed in a "*Financial Memorandum*" which is intended to detail the Employer's financial arrangements and should be attached to the contract. This gives the opportunity for the Employer to mandate (if that is its wish) that its financial arrangements are deemed acceptable by the Contractor. However, Employers under the Gold Book will still need to exercise caution and consider further specific amendments, as Sub-Clause 2.4 contains a similar final sentence as the versions in the Red, Yellow and Silver Books. Thus, if the Employer under a long-term design, build and operate contract based on the FIDIC Gold Book intends to make any material changes to its financial arrangements or finds that it must do so because of changes to its financial or economic situation (which could well occur during the extended operational phase), it must give notice to the Contractor. This brings with it the same obligation as was faced by the Employer in the *NIPDEC* case.

In this commentator's view, Employers (and their funders) are more likely, post *NIPDEC*, to require the wholesale deletion of Sub-Clause 2.4.

Employer's claims under FIDIC (Issue No.2)

The other significant issue decided in *NIPDEC* concerns Sub-Clause 2.5 of the FIDIC form and notices of claim by the Employer. Again, this provision appears in each of the Red, Yellow and Silver Books in near identical language and is therefore of wide application on international projects which utilise the FIDIC standard form conditions.

It may be helpful to break the clause down into its constituent parts. In common with the drafting style of FIDIC, a number of separate points are located within a single Sub-Clause. Sub-Clause 2.5 commences with the following:

> *"If the Employer considers himself to be entitled to any payment under any Clause of these Conditions or otherwise in connection with the Contract … he shall give notice and particulars to the Contractor…"*

16 *The FIDIC Contracts Guide* (ISBN 2-88432-022-9), First Edition 2000.

17 *Conditions of Contract for Design, Build and Operate Projects* (ISBN 978-2-88432-052-8) First Edition 2008.

This opening provision requires the Employer to take the initiative and give a notice to the Contractor. It is a mandatory requirement, denoted by use of the word "*shall*". It follows that if the Employer fails to give notice, it will be in breach of contract. However, any such failure will have other serious consequences, as we shall see.

Another important provision within Sub-Clause 2.5 deals with the time for giving notice, and provides:

> *"The notice shall be given as soon as practicable after the Employer became aware of the event or circumstances giving rise to the claim."*

The interesting point to note here is the contrast with the requirements for the giving of notice required from the Contractor when giving notice of its claims against the Employer, under Sub-Clause 20.1 of the FIDIC form. In the case of the Contractor "*notice shall be given as soon as practicable, and not later than 28 days after the Contractor became aware, or should have become aware, of the event or circumstance*". In contrast, there is no long-stop date for Employer's claims. This might appear to suggest a less strict regime for the Employer in the provision of such notices but there is a sting in the tail of Sub-Clause 2.4, as we shall see below.

As to details of the claim to be given, Sub-Clause 2.5 provides:

> *"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."*

Clearly, the intention here is that the Contractor is given sufficient details to be able to assess and respond to the Employer's claim.

It should also be noted that under FIDIC, Employer's claims are subject to the Determination machinery of Sub-Clause 3.5. This involves the Engineer (under the Red and Yellow Books) making a Determination of whether and if so how much is due to the Employer.[18] Thus, these details to be provided by the Employer are also necessary so that the Engineer can do his job.

Notice requirements for Employer's claims as a condition precedent to entitlement

The sting in the tail of Sub-Clause 2.5 was identified by the Privy Council in *NIPDEC* as being significant. This states:

> *"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."*

This also provides a point of contrast with the regime for Contractor's claims under Sub-Clause 20.1. As noted above, that requires a longstop period of 28 days for the Contractor to give notice. Sub-Clause 20.1 also includes express language which spells out the consequences of non-compliance with the notice provisions:

> *"If the Contractor fails to give notice of a claim within such period of 28 days, the Time for Completion shall not be extended, the Contractor shall not be entitled to additional payment, and the Employer shall be discharged from all liability in connection with the claim."*

In common law jurisdictions, most commentators would regard the drafting of Sub-Clause 20.1 of the FIDIC form as making due notice from the Contractor a condition precedent to its entitlement to pursue recovery of its claims. The House of Lords has given

18 Under the Silver Book, where there is no independent Engineer engaged to administer the contract, the Employer determines the validity and quantum its own claims, albeit the Contractor may give notice of dissatisfaction of any such Determination within 14 days.

guidance on the necessary ingredients for an effective condition precedent clause under English law. The reference point is the dictum of Lord Salmon in *Bremer Handelsgesellschaft mbH v Vanden Avenne-Izegem PVBA* [1978]:[19]

> *"In the event of shipment providing impossible during the contract period, the second sentence of cl. 21 requires the sellers to advise the buyers without delay of the impossibility and the reasons for it. It has been argued by buyers that this is a condition precedent to the sellers' rights under that clause. I do not accept this argument. Had it been intended as a condition precedent, I should have expected the clause to state the precise time within which the notice was to be served, and to have made plain by express language that unless the notice was served within that time, the sellers would lose their rights under the clause."*

Thus, the ingredients for an effective condition precedent are often said to be that a precise period of time is stated within which notice must be given and the consequences of any non-compliance with that time period are spelt out expressly. The language of Sub-Clause 20.1 appears to satisfy these requirements, with the effect that if the Contractor fails to give notice within the prescribed period, it forfeits its claim. Indeed, this interpretation was found to apply by Mr Justice Akenhead in *Obrascon* [2014][20], a case decided under a contract based on the FIDIC Yellow Book terms.

This gives rise to the question as to whether the requirements of Sub-Clause 2.5 for Employer's claims contain the necessary ingredients for an effective condition precedent, at least in common law jurisdictions. Thanks to the Privy Council in *NIPDEC*, we now have an answer and it is not good news for Employers. Lord Neuberger said this of Sub-Clause 2.5:

> *"Its purpose is to ensure that claims which an employer wishes to raise, whether or not they are intended to be relied on as set-offs or cross-claims, should not be allowed unless they have been subject of a notice, which must have been given 'as soon as practicable."*[21]

> *"...the natural effect of the closing part of clause 2.5 is that in order to be valid, any claim by an Employer must comply with the first two parts of the clause , and that this extends to, but, in the light of the word 'otherwise' is not limited to, set-offs and cross claims"*[22].

The Privy Council looked at the purpose of the provision and identified that under FIDIC, the claims machinery applicable to Employer's claims leads directly into the Determination process under Sub-Clause 3.5. As noted under Sub-Clause 2.4:

> *"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."*

Immediately after the provision of such particulars, the linkage with the Determination process is found:

> *"The Engineer shall then proceed in accordance with Sub-Clause 3.5 [Determinations] to agree or determine (i) the amount (if any) which the Employer is entitled to be paid..."*

Thus, in *NIPDEC* (Issue No.2) the Court observed:

> *"If an Employer's claim is allowed to be made late, there would not appear to be any method by which it could be determined as the Engineer's function is linked to the particulars, which in turn has to be served as soon as practicable"*[23]

19 [1978] 2 Lloyd's Rep 109 (HL) at 128, col 2.
20 *Obrascon Huarte Lain SA v Attorney General for Gibraltar* [2014] EWHC 1028 (TCC).
21 Paragraph 38 of Privy Council Judgment.
22 Paragraph 39 of Privy Council Judgment.
23 Paragraph 38 of Privy Council Judgment.

NIPDEC is therefore persuasive authority for the proposition that if there is no valid Employer's claim under Sub-Clause 2.5, there can be no Determination under Sub-Clause 3.5. So even with what may otherwise be a valid claim by an Employer, if it is notified later than "*as soon as practicable*", it cannot proceed under Sub-Clause 2.5. This could affect Employer's claims to deduct liquidated damages or to recover costs incurred where it rectifies itself defective works which the Contractor has failed to rectify.

The Court did not provide any definition of how long a period is envisaged by the words "*as soon as practicable*". Clearly, that will depend on the facts in each particular case. However, it may be observed that the approach of the Privy Council in *NIPDEC* does not strictly satisfy Lord Salmon's guidance in *Bremer v Vanden* as to an effective condition precedent clause being expected "*to state the precise time within which the notice was to be served*"

This also leads to the surprising conclusion that the absence of a 28 day (or any) longstop in Sub-Clause 2.4, means that the requirement for an Employer's claim notice has the potential to be more demanding than that for a Contractor's under FIDIC forms; "*as soon as practicable*" may well expire sooner than 28 days after the Employer considers himself to be entitled to any payment.

Not all Employer complaints are time barred

The decision in *NIPDEC* is also persuasive authority for the proposition that where the Employer fails to notify a claim in accordance with Sub-Clause 2.5:

> *"the back door of set off or cross- claims is as firmly shut to it as the front door of an originating claim."*[24]

Thus, non-compliance with Clause 2.5 means that the Employer cannot use set-off to reduce its exposure to the Contractor's claims or to any cross claims separately. However and importantly, it will be noted that Sub-Clause 2.5 is concerned with "*entitlement to payment*" and the giving of notices to this effect. Sub-Clause 2.5 does not preclude the Employer from raising an abatement argument, namely that the work for which the contractor is seeking payment was poorly carried out such that it does not justify any payment or is worth materially less than the unit rate or lump sum price in the contract.

The case was remitted to the Arbitrator to disallow sums which (i) were not subject of notification in accordance with Sub-Clause 2.5 and (ii) could not be characterised as abatement claims. Not good news for the Employer.

A recent decision of Mrs Justice Carr, in the Technology & Construction Court in London, provides a further level of analysis concerning the Employer's claim machinery under FIDIC: *J Murphy & Sons Ltd v Beckton Energy Ltd* [2016].[25]

In the *Beckton Energy* case, the contract which gave rise to the dispute was based on the FIDIC Yellow Book. Murphy was seeking a declaration that the Employer first had to obtain a Determination of the Engineer in its favour under Sub-Clause 3.5 before it could lawfully deduct liquidated damages for delay. The liquidated damages claim of the Employer was substantial, amounting to some £8.274m.

Sub-Clauses 2.5 and 3.5 of the contract in the *Beckton Energy* case were unamended from the FIDIC standard form. Following *NIPDEC*, one might therefore have expected the declaration to be granted in favour of Murphy. However, the Court found that the obligation to pay liquidated damages under the Sub-Clause 8.7 arose independently of Sub-Clauses 2.5 and 3.5 and was not contingent upon an Engineer's Determination. Importantly in this regard, the contract in *Beckton Energy* had been amended. In Sub-Clause 8.7, the words "*subject to Sub-Clause 2.5*", qualifying Murphy's obligation to pay liquidated damages, had been

24 Paragraph 40 of Privy Council Judgment.

25 *J Murphy & Sons Ltd v Beckton Energy Ltd* [2016] EWHC 607

deleted. Rather, the bespoke drafting of Sub-Clause 8.7 meant that the obligation to pay liquidated damages for delay was contingent only on the Contractor failing to achieve the required milestone date for completion.

Similarly, in the *Beckton Energy* case the standard form of FIDIC bond wording had been rejected. That FIDIC wording expressly limited the Employer's right to calling the Bond only when the Engineer had made a Determination. That provision was removed, thereby providing the Court with another indicator that the parties did not intend the Employer's right to deduct liquidated damages to be contingent on the use of the Employer's claim machinery.

The Court in *Beckton Energy* found that the deletion of words from the FIDIC standard form was "*only context and by no means determinative*" but it was nevertheless "*relevant background*" which the Court was entitled to take into account in determining the objective intention of the parties and interpreting the true meaning of the particular provisions in issue.

The decision in *Beckton Energy* therefore illustrates the importance of bespoke amendments to the FIDIC forms of contract. The Court in *Beckton Energy* commented that the amendments had not been fully thought through, noting the *NIPDEC* decision and the tension between Sub-Clause 2.5 and the liquidated damages deduction provision in Sub-Clause 8.7, even had the words in the FIDIC standard form not been deleted. However and on balance, the Court found that the right to deduct liquidated damages in Sub-Clause 8.7 (with its bespoke amendment) created a self-contained and separate right of the Employer to make deductions against or require payment from the Contractor, independent of the Employer's claim machinery in Sub-Clause 2.5 or the Determination machinery in Sub-Clause 3.5. It is unlikely that this would be the case in an unamended FIDIC contract, applying the reasoning in *NIPDEC*.

Impact of the common law

Thanks to the common law doctrine of precedent, cases such as *NIPDEC* have the potential to affect the conduct of parties and their approach when negotiating FIDIC forms of contract globally. Employers and their funders will likely remove Sub-Clause 2.4 (*Employer's financial arrangements*) in light of *NIPDEC* decision.

Cases such as *Beckton Energy* serve to emphasise the importance of clarity when drafting amendments to FIDIC (and other standard form) contracts and may also encourage those advising Employers to make amendments to the FIDIC terms so that even if the Employer is found not to have complied with the claims machinery in Sub-Clause 2.5, its right to deduct liquidated damages remains intact.

The Privy Council decision in *NIPDEC* applies common law principles to two important provisions found in some of the main forms of FIDIC contract used on projects internationally. However, where the governing law of the FIDIC contract is based on another legal system, such as civil law or Sharia law, the same result as was found to apply in *NIPDEC* may not prevail. Even so, with the world's population in 2016 estimated to be approaching 7.5 billion,[26] by my calculations the common law still applies to about 2.5 billion people. Not all of them will be involved in the construction sector but many will be affected by the assets built under FIDIC forms.

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