

**International Construction Contracts and Dispute Resolution
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Presentation Notes on:

CLAIMS OF THE EMPLOYER

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1. Introduction

I have been asked to say something about claims of the Employer under the FIDIC forms of contract. I admit that I would rather have talked about claims of the Contractor, because that would have been more straightforward. It seems to be in the nature of the game that in the great majority of cases, as far as claims are concerned, it is the Contractor 'who is in the driving seat'. Usually the Contractor is the one asking for extra time or payment, and it is he who usually (nowadays) has the organisation that is on the look-out for matters possibly causing him extra time or cost. Employers, on the other hand, as a rule, are more passive (if not sometimes unconscious) of their claim right against the Contractor. It is often not until some part fails that an Employer begins to consider a claim against his Contractor.

The clauses of the FIDIC forms have been prepared so that they first set out the duties and obligations of the parties, and then they go on to say what happens if each of those duties or obligations is not carried out. Most of the clauses naturally set out what the Contractor shall do and how he shall do it. If he fails, e.g. if the quality of any of the work is not up to the required standard or if an item of equipment is missing, then the Employer, theoretically speaking, has a claim against the Contractor. What normally happens, however, is that the Employer just does not pay the full contract amount for that piece of work. If that piece of work has been approved and actually paid for, and later is revealed to be defective or below standard, the usual procedure is for the Employer (or the Engineer) to simply deduct the relevant amount from the next payment certificate.

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This procedure is normal and fully acceptable provided that the deductions or withholding of payment are fair and proper. Here comes the problem of deciding whether the deduction or withholding is fair and proper or not. The solution is to have an impartial Engineer acting properly. However, difficulties and disputes will arise if the Employer wishes to make unfair deductions or withholding of payments, and either there is no Engineer or the Engineer for any reason does not act impartially.

2. The Traditional Pre-1999 FIDIC Forms of Contract

The situation for the ‘Old Red and Yellow Books’, i.e.:

- Conditions of Contract for Works of Civil Engineering Construction (1987)
- Conditions of Contract for Electrical and Mechanical Works including Erection on Site (1987)

was as described above, in that there was an Engineer who was required to act impartially² when, for example, giving decisions or determining values.

Apart from withholding of payment for work or obligations not satisfactorily carried out, certain particular clauses did give the Employer the specific right to claim. The claims could either be for monetary recompense or for extension of the Defects Liability Period (DLP), i.e. the ‘guarantee period’. An example of monetary recompense would be the payment of liquidated damages if the Contractor was late in completing the Works³. An example of extension of the DLP would be if any of the installed plant failed and replacement parts were required, then the full DLP would be required for the replacement parts⁴.

The really serious claims that an Employer might have usually come about because completed work or equipment fails in one way or another during the DLP. Cracks may occur in the concrete works or the generators may burn out. In principle the Contractor is responsible for rectifying such failures, but the real difficulties and large claims arise when the Contractor can not or will not rectify the failure. We have all heard of serious cases where the Contractor is probably very late and incapable of completing the work or rectifying serious failures. There are clauses dealing with default of the Contractor⁵, which allow the Employer to terminate the contract and expel the Contractor from the site. Thereafter the Employer may have the Works completed by others, theoretically at the cost of the Contractor. By this time, however, the Contractor is usually bankrupt and will anyway be unable to meet the Employer’s claims, (apart from the performance bond and any other monies the Employer may have been withholding).

² Red Book Clause 2.6; Yellow Book Clause 2.4.

³ Red Book Clause 47.1; Yellow Book Clause 27.1.

⁴ Yellow Book Clause 30.4

The situation for the 'Orange Book', the Conditions of Contract for Design-Build and Turnkey (1995), was basically the same, except that there was no Engineer and that the DAB had been introduced. It is to be noted that both the Yellow and the Orange Books included a limitation of liability clause, whereby the Contractor would not be liable to the Employer for any indirect or consequential damages and where his total liability normally would not exceed the contract price.

3. The 1999 Suite of Standard Conditions of Contract

FIDIC's new (1999) Standard Forms of Contract for major works, are:

- **Conditions of Contract for Construction** for Building and Engineering Works Designed by the Employer : *The Construction Contract* (New Red Book)
- **Conditions of Contract for Plant and Design-Build** for Electrical and Mechanical Plant, and for Building and Engineering Works, Designed by the Contractor: *The Plant and Design/Build Contract* (New Yellow Book)
- **Conditions of Contract for EPC/Turnkey Projects** : *The EPC/Turnkey Contract* (Silver Book)

Based on long experience of often mismanaged and/or late claims from many Contractors, and, indeed, general mishandling of claims by some Employers/Engineers, the drafters of the New Books have sought to generally tighten up the rules concerning all claims. This has resulted in several innovations.

Regarding Employers, it can be said that in the past Employers or their Engineers have often summarily withheld payment of monies which they considered were – for one or another reason – not due to the Contractor. Sometimes they have similarly de facto extended the Defects Liability Period. To try to prevent unfair withholding of monies or extensions of the 'guarantee' period, the New Books – in an entirely new Sub-Clause 2.5 – prescribe a procedure which *has* to be followed by the Employer if he considers himself to be entitled to *any* payment under or in connection with the Contract, or considers himself to be entitled to an extension of the Defects Notification Period (the new, more correct, term for the Defects Liability Period).

There are in fact a number of individual Sub-Clauses which do give the Employer entitlement to claim payment from the Contractor or an extension of the DNP. (These are actually listed on pages 90-93 of The FIDIC Contracts Guide). For example, if there is a change of law in the country which reduces the

⁵ Red Book Clause 63.1; Yellow Book Clause 45.2.

Contractor's costs the Employer may claim this reduction, or if plant fails to pass prescribed tests then the Employer may claim non-performance damages.

The said Sub-Clause 2.5 requires notice and particulars, and the significant points are:

- Employer shall give notice as soon as practicable after becoming aware of event or circumstance giving him entitlement to any payment from Contractor
- notice relating to extension of DNP to be given before expiry of such period
- particulars to specify Clause or other basis for claim, with substantiation
- extension of Defects Notification Period (as Cl 11.3) for defect or damage preventing use
- notice shall comply with Cl 1.3, i.e. in writing and properly delivered
- progress reports – Cl 4.21(f) – must list notices given
- no response required from Contractor
- particulars may be given at any time
- claim then subject to Cl 3.5, i.e. Engineer (EPCT Employer) endeavours to agree and settle the claim, failing which he determines
- any amount so determined is deducted from Payment Certificates (EPCT moneys due)
- any extension so determined is added to DNP
- by Cl 14.7 Employer has to pay the amount certified (CONS and P&DB)
- for EPCT Cl 14.7 Employer must pay the net amount actually due, not the amount the Employer considers to be due
- if the DAB decides that Employer has paid less than the amount due, Contractor would be entitled to financing charges under Cl 14.8

Sub-Clause 2.5 therefore imposes a claims procedure on the Employer and *prohibits him from making deductions from payments due to Contractor until claims procedure has been followed* which is a completely new requirement.

Certain people have complained that Employer only has to give notice 'as soon as practicable', and that this 'demonstrates an unfair imbalance' compared with the case of claims from Contractor. The reason is simply that in the great majority of cases, as far as claims are concerned, it is the Contractor 'who is in the driving seat', as mentioned earlier. He is, usually, on the lookout for matters to claim, whereas Employers are usually not so active as far as 'claimsmanship' is concerned. It is easy for a lawyer to shout 'unfair imbalance', but the reason is obvious to a practical engineer.

4. Conclusion

It is hoped that the new stricter rules, with the requirement for both the Contractor and the Employer to follow a specified procedure, will reduce some of the difficulties currently being met with regarding claims. For the Contractor, a strict time limit has been introduced for notification of his claim, so that all parties are made aware that a claim exists and can keep proper records and perhaps avoid unnecessary consequences. For the Engineer, he is now required to give his response, at least on the principles of the claim, within a set time (which was not the case before). For the Employer, he now is not entitled to deduct any monies, nor extend the Defects Notification Period, unless he has followed the set procedure of notification, and then determination.
