Holst, newsletter

FIDIC Conditions of Contract – 2017 update

FIDIC is expected to release the updated versions of its immensely popular Conditions of Contract for various types of construction work later this year. Details of the upcoming changes are slowly dripping into the public domain, e.g. more process oriented clauses dealing with the most important procedures, improved incentive for the Contractor to perform value engineering, and a fundamentally different approach to claims procedures. The updated Conditions of Contract will be more modern and coherent but certain changes are likely to cause some controversy.

FIDIC is the international federation of consulting engineers with member organisations in almost 100 countries worldwide. For more than 100 years, FIDIC has strived to improve the standards of ethics and integrity among all stakeholders involved in the development of infrastructure worldwide, and, in the furtherance of its goals, has published e.g. international standard forms of contracts for works.

The latest suite of Conditions of Contract was published in 1999 and quickly became the default choice for numerous international construction and infrastructure projects worldwide. The 1999 Conditions of Contract are generally considered amongst the most commonly used standard forms of contracts in international construction work.

For some years now, FIDIC has been working on updated versions of the 1999 Conditions of Contract based, inter alia, on experience derived from the 1999 versions as well as the latest developments within the construction industry. FIDIC has announced that a fully updated suite of the main contract conditions will be released to the public later this year, and draft versions of the Conditions for Construction (the Red Book) and EPC/Turnkey (the Silver Book) are presently undergoing friendly review by a group of select international experts within the industry.

Even though the details of upcoming changes are still confidential we are now able to reveal some of the expected changes thanks to a pre-release beta version of the Plant & Design-Build conditions (the Yellow Book) made available by FIDIC during the International Contract Users' Conference in London in December 2016 where Jakob was speaking at the main conference.

FIDIC set to continue to be industry leading

Despite increased competition from especially UK based standard forms, with the envisaged updates the FIDIC Conditions of Contract will undoubtedly continue to be the market leader and form an even more suitable basis for construction projects around the world. The industry may freely decide to continue using the 1999 versions even after the updates (after all, the use of the pre-1999 Conditions is still widespread), however it will most likely be advisable to switch to the updated editions for future projects.

Because the new editions will be updates and not re-writes, the bulk of accumulated experience from the 1999 versions remains relevant also under the 2017 editions. However, some of the suggested updates are either generally too far-reaching for some (Contractors, Employers or financing institutes) or not suitable in all projects.

The need to seek individual, competent advise on drafting construction contracts will not be reduced by the updates; quite to the contrary.

Updates to the existing contract conditions

The 2017 editions will be updates to the existing contract conditions rather than a completely new set of conditions. Consequently, the general structure is unchanged (even

though we will have 21 clauses instead of the present 20 but this is primarily because Cl. 20 has been split into two clauses).

However, we can expect substantial changes to the content.

Many of the changes relate to more elaborate and operational flow descriptions for the most important procedures. Hence, the contract conditions have become even more practical, and the 2017 contract conditions will – undoubtedly – play a more active role in the day-to-day project management.

Amongst the main changes are:

Enhanced Processes

Detailed step-by-step descriptions of the major processes, e.g. payment procedures.

Even though the 1999 versions do contain some procedures, the 2017 editions will be far more detailed and hands-on oriented.

FIDIC has always had the ambition that the Conditions of Contract should not only serve as "bill of rights" for lawyers doing arbitration but also as a practical guide or handbook for the parties during construction. Especially with the 1999 Conditions of Contract the industry was offered a handbook where decades of experience was codified to support swift and fair procedures and guidance.

With the expected revisions and extended process descriptions chances are the conditions will be used even more as an often-used guide or handbook for the resident engineer rather than just sitting in a drawer or on the shelf.

Advance Warning Provisions

Increased level of attention to planning and programming, including detailed requirements to the Contractor's programme. In line with this, the 2017 editions will include extended "Advance Warning" clauses ensuring early identification and communication of potential adverse events or circumstances.

The 1999 Conditions of Contract include brief advance warning provisions primarily imposing notification obligations on the Contractor. That is about to change because not only are the advance warning provisions more elaborate and detailed they now also apply to the Employer.

This is much welcomed and will facilitate a more modern approach to project management where risks are identified as early as possible and where deviations from the planned execution and progress of the work are identified and addressed by the parties as early as possible.

Value Engineering

Substantial expansion of the present Value Engineering clause providing an incentive for the Contractor to perform value engineering, e.g. by allowing the Contractor to take a share of any net gain resulting from the Contractor's value engineering efforts.

Under the 1999 edition the Contractor may propose changes based on value engineering, however, no incentive for the Contractor was provided, any proposal should be prepared at the cost of the Contractor and, apparently, only the Employer would benefit from a proposal.

The 2017 editions will entitle the Contractor to a share of the net benefits derived from a value engineering proposal. However, the suggested clauses do not seem fully developed yet and these clauses may need some supplementary clauses in the Particular Conditions to fully work.

Even though the vast majority of the changes substantially improve the contract conditions, some suggested changes are controversial and are likely to generate some debate. Some changes appear less carefully prepared and thought-through.

Unlimited Liability

It is suggested that the Contractor assumes unlimited liability for the Works' fitness for specified purpose. As the fitness for purpose liability is already subject to some discussions the suggested unlimited liability will likely not sit well with the contractors. During the 2016 Users' Conference in London FIDIC did not offer any detailed reasoning for this change and if maintained in the final versions, it is expected the contractors will fight this change during contract negotiations. As always, the employers must consider whether an unlimited liability in this respect is required or even beneficial to the specific project.

(Much) Enhanced Dispute Resolution Provisions

The clauses addressing dispute prevention and resolution have been substantially modified and expanded: the clauses dealing with dispute resolution are likely to cover more than 10 pages (up from approx. 4 pages in the 1999 versions). However, more is not always better, and detailed escalation procedures with several cut-off provisions promote an adversarial approach by the parties and not cooperation.

Additional Cut-off Provisions – Also for Employer's Claims

One of the much-debated clauses in the 1999 version was the 28 days cut-off provision in Sub-Clause 20.1. This cut-off clause has been much criticised, and in many jurisdictions it will not be upheld in full by the courts (or arbitration tribunals). Especially under continental European law, when deciding on the consequences of a late claim, the relevant court may take into consideration the actual consequences to the other party of a delayed claim notice, including any prevention or prejudice to a proper investigation of the claim. Furthermore, in my experience Employers and Engineers tend to use the cut-off clause with a light hand, and the reality is probably that the 1999 cut-off clause is invoked primarily when a delay in notifying has had real consequences for the Employer, much in line with the last – and much softer – paragraph in the present Sub-Clause 20.1.

Nevertheless, FIDIC proposes to introduce even more cut-off clauses, including imposing a cut-off effect to a delay in providing supplemental documentation (instead of the present last paragraph of Sub-Clause 20.1 mentioned above). In an effort to soften this, it is suggested to allow the DAB (and a subsequent arbitration tribunal) to disregard a late notice if it is deemed "fair and reasonable that the late submission be accepted". However, the effect of this may be counter-productive as this provides a clear incentive to escalate a claim rejected due to late notice to receive absolution and, consequently, this solution is likely to increase the number of disputes between the parties during the construction phase, not reduce it.

In addition, it is suggested that the cut-off clauses will apply to all Employer's claims, including – much later – claims relating to defects in the work.

Consequently, the Employer may have to notify the Contractor if the Employer becomes aware of any circumstance or event that COULD give rise to a claim at a (much) later stage. The challenge – and, hence, the uncertainty of the actual effect – is that it is very difficult with confidence to establish the starting point for calculating the 28 days period; when should the Employer have realised that a specific method of construction, chosen by the Contractor, eventually leads to the Employer's Requirements not being fulfilled?

For obvious reasons the Employer can only know this with certainty when the Works have been completed, because the Employer does not have full insight into the future work of the Contractor, so any potential issues may very well be remedied by the Contractor's later work – or it may not, in which case the Employer must give notice, but when?

Rather than addressing the imperfections of the cut-off clause of the 1999 versions, FIDIC is in the process of throwing the baby out with the bathwater. The important issue in relation to timely notification of claims is not to cut off claims but to ensure that claims are notified in a timely manner to avoid negative impact on the progress of the work and the cooperation between the parties. Hence, any issue should be addressed in open dialogue and, if needed, with the assistance of third parties like the DAB or through other means. Addressing this issue by sheer force, i.e. cutting off any claim that is not filed in a timely manner, does not promote positive attitudes or cooperation; quite the opposite.

Furthermore, there is an incentive for either party to escalate any dispute to the DAB or subsequently arbitration to seek protection under the "fair and reasonable" exception, if a claim is rejected by the Engineer due to (alleged) late notice.

Maybe time has come to abandon the concept of cut-off altogether and accept cut-off solely if and to the extent the delay has had – or will have – a negative impact on the other party.

Higher Complexity – Reduced Usability

Another area where the 2017 editions are set to take a step backwards is the ease of editing.

For the 2017 editions FIDIC has – wisely, in my opinion – abandoned the idea of an ad hoc DAB (the users must choose between an ad hoc and a standing DAB when drafting contracts based on the 1999 versions), and a standing DAB will now form part of all major contract conditions. However, the DAB is envisaged to form an integral part of the dispute prevention and resolution process to a much higher degree than under the 1999 versions. Consequently, it is very difficult from a drafting point of view to delete the DAB from the contract.

Even though the DAB institute has proven to be very effective in the management of claims and prevention of disputes, there will be projects where a DAB is not suitable, e.g. the operating costs of a standing DAB may very well be prohibitive.

In the 1999 versions, it is fairly simple to customize the claims procedures in the Particular Conditions to fit the specific project, e.g. to remove the DAB. In the upcoming versions, this will be far less simple.

The return of the Engineer as an impartial being

Apparently, the 2017 editions will also see the return of the Engineer as an impartial being.

The concept of impartiality was an integral part of the pre-1999 Conditions but it was more or less abandoned in 1999 and replaced by the "fair determination" criteria in Sub-Clause 3.5 of the 1999 versions.

One of the major objections pre-1999 to the concept of impartiality was that – in most projects – impartiality was an illusion. The Engineer is appointed by the Employer, and even though the Engineer is not easily replaced, the Engineer is acting under an authority that is solely derived from the Employer, hence, in reality the Engineer is not likely to act impartially.

However, FIDIC is suggesting that under the 2017 editions, occasionally the Engineer will be under an obligation to act "neutrally" between the parties. Exactly what "neutrally" means is not specified in the present drafts, and this is hopefully one area where the final versions will improve from the circulated drafts.

Generally, it is not advisable to draft contract conditions contrary to basic human nature. The 1999 system, where it is clear that the Engineer is representing the Employer and the Engineer is not required to act neutrally or impartially but only fair, establishes a realistic and operational approach.

The use of the word "neutrally" is possibly even worse than an obligation to act impartially. "Neutral" can be construed to mean not only impartial but also without applying any previous experience from the specific project or other similar projects. In other words, taking the Contractor's previous behaviour into consideration may be construed as NOT acting neutrally. Furthermore, and more importantly, when the Engineer decides on a claim, the Engineer may very well be exposed to liability towards the Employer and – regardless of the "deemed acting for the Employer" wording – also towards the Contractor if the Engineer fails to act "neutrally" as this terms may subsequently be construed.

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Jakob focuses on advisory work and dispute resolution in relation to complex contracts. Jakob has been working with international commercial law since the late 1980s focusing on international turnkey projects, project development, international construction, dispute resolution and international litigation (including arbitration).

Jakob has been involved in construction projects in more than 50 countries world-wide. Specialties: Advising on developing, implementing, managing and operating complex structures (infrastructure, utilities, manufacturing and storage facilities, dairies, breweries, ICT-projects etc.), incl. dispute resolution in relation thereto.

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With more than 40 years of experience working with international projects, including FIDIC-based agreements in Europe as well as on other continents, Holst, offers highly specialised and efficient advice on all stages of construction projects. Holst, further has widespread and in-depth experience in litigation and dispute resolution before the ordinary Danish courts of law as well as arbitration tribunals.