# FIDIC contracts – What protection do they give contractors for employer financial problems?

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In all construction contracts, one of the central principles is the Employer's obligation to pay the contract price. The Contractor will be wary about the Employer's financial standing and ability to pay and concerned to ensure that payments are made on time and that effective remedies are available in case of late or non- payment. The FIDIC standard forms of contract contain provisions dealing with these aspects.

## Security for payment by the Employer

The FIDIC forms do not require the Employer to provide security for its payments to the Contractor and it is unusual for the Employer to provide such security. That said, the *Guidance for the Preparation of Particular Condition*s, included within each FIDIC book, contains example provisions which contemplate some form of Employer payment guarantee in two circumstances.

The first (which appears in the 1999 RB and SB and is a provision that may be required by a financing institution) may provide that any portion of the contract value which is to be paid directly by the Employer upon shipment of items of Plant is to be made by an irrevocable letter of credit issued by the Employer in favour of the Contractor. The second (which appears in the 1999 and 2017 RB, YB and SB) may apply if the Contractor is prepared to arrange interim finance for the project. In this case, the Contractor may require a payment guarantee by the Employer in respect of payments which the Employer is (eventually) required to make. These editions include at Annex G an example Employer payment guarantee in the form of an on-demand bond, although the entity issuing the security may of course use its own form.

## Evidence of Employer's financial arrangements

The FIDIC forms contain at clause 2.4 provisions intended to reassure the Contractor about the Employer's ability to comply with its payment obligations.

There will potentially be detailed negotiations about clause 2.4, especially if financing institutions are involved. They may seek to amend the clause to limit the Contractor's rights or to require the Employer to make payments from its own resources if funds under the financing arrangements are insufficient to meet the payments due to the Contractor. It may be the case that financing institutions will not pay for significant variations or additional costs incurred as a result of Employer-caused delay or disruption, in which case the Contractor will need to satisfy itself that the Employer has funds from other sources to pay these amounts.

**1999 editions**
In the 1999 editions, the Contractor may request 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, as estimated at that time, in accordance with clause 14. The Employer must

provide this evidence within 28 days of the request. If the Employer intends to make any material change to its financial arrangements, it is required to give notice to the Contractor with detailed particulars.

Clause 2.4 does not explain what 'reasonable evidence' is or whether this is a subjective or objective test, nor does it state who should carry out the estimate of the Contract Price. These are potential areas of disagreement.

If the Employer fails to comply with clause 2.4, the Contractor may (after giving notice) suspend work or reduce the rate of work under clause 16.1, 'unless and until' it receives the 'reasonable evidence'. It therefore appears that only an Employer's failure to give 'reasonable evidence', and not a failure to give notice of an intention to change financial arrangements, gives the Contractor a right to suspend. If the Contractor does not receive the 'reasonable evidence' within 42 days after giving notice under clause 16.1, the Contractor is entitled to terminate under clause 16.2 after giving further notice. Notwithstanding the above, protection of the Contractor is limited because there is nothing it can do if the Employer notifies an adverse change in its financial arrangements.

**2017 editions**
Clause 2.4 is amended in the 2017 editions.

The Employer must now provide in the Contract Data details of its financial arrangements. If the Employer intends to make any material change to these arrangements affecting its ability to pay the Contract Price remaining to be paid at that time, as estimated by the Engineer (RB and YB) or Employer (SB), or if it has to do so because of changes in its financial situation, the Employer must give immediate notice to the Contractor with detailed supporting particulars.

The Contractor may still request the Employer to provide 'reasonable evidence' of its financial arrangements but this is no longer a general right and is restricted to three situations: (i) if the Contractor receives a Variation with a price greater than 10% of the Accepted Contract Amount (YB and RB) or Contract Price (SB); (ii) if the Contractor does not receive payment in accordance with clause 14.7; and (iii) if the Contractor becomes aware of a material change in the Employer's financial arrangements which has not already been notified under clause 2.4. If the Employer receives this request it must provide the 'reasonable evidence' within 28 days. There is still no explanation about what may constitute 'reasonable evidence'.

If the Employer fails to provide the 'reasonable evidence' in accordance with clause 2.4 *and* such failure constitutes a material breach of the Employer's obligations under the Contract, the Contractor may (after giving notice) suspend work or reduce the rate of work under clause 16.1. The requirement for the failure also to constitute a material breach is new and raises the threshold for the Contractor's suspension under this clause. If the Contractor does not receive the 'reasonable evidence' within 42 days of giving notice under clause 16.1, the Contractor is entitled to give a notice of intention to terminate under clause 16.2.1(a).

Although the 2017 editions should help to ensure transparency about the Employer's financial arrangements from the outset by requiring details to be inserted in the Contract Data, there is still no protection for the Contractor if the Employer notifies an adverse change in its financial arrangements, and the Contractor's protection is curtailed because the 2017 editions limit the situations during the running of the project in which it may require evidence of the Employer's arrangements.

## Late or non-payment

In case of late or non-payment by the Employer, the Contractor has three remedies under these FIDIC forms.

First, the Contractor is entitled under clause 14.8 to financing charges (interest) if the Contractor does not receive payment in accordance with clause 14.7 on payment. This is an important practical remedy which applies during the running of the Contract, assuming payment of interest is permissible in the relevant jurisdiction. The Contractor is entitled to (under 1999 editions) or may request (under 2017 editions) these financing charges without formal notice or certification and remains entitled during the period of delayed payment.

Second, the Contractor is entitled under clause 16.1 to give notice and then reduce the rate of work or suspend work (and if this causes delay/Cost the Contractor may also be entitled to an extension of time/Cost plus profit). A reduction in or suspension of work should act to focus the Employer on the need to rectify the payment situation.



Third, the Contractor is entitled under clause 16.2 to terminate if it does not receive payment of interim amounts within 42 days after expiry of the time stated in clause 14.7. The precise language here is different depending on the book and the edition. The Contractor may terminate upon giving 14 days' notice (1999 editions) or after giving notice of intention to terminate, followed 14 days later by a second notice to immediately terminate (2017 editions). Clause 17.6 (1999 editions), clause 1.14 (2017 SB) and clause 1.15 (2017 RB and YB) exclude liability for loss of profit and indirect loss (etc) but expressly do not apply to payment on termination under clause 16.4. Therefore, the Employer may have unlimited liability to the Contractor for loss of profit or other loss or damage sustained by the Contractor as a result of termination under clause 16.2.

## Employer insolvency

If the Employer becomes bankrupt or insolvent or similar, the Contractor is entitled to terminate the Contract (clause 16.2). The precise wording differs between the 1999 and 2017 editions. Different jurisdictions have different procedures in respect of companies in financial difficulty. It may be problematic to determine whether a particular procedure falls within the wording of this clause. If a Contractor terminates under clause 16.2, the same consequences apply as for termination for non-payment by the Employer.

## Employer termination for convenience

An Employer in financial difficulty may try to terminate the Contract for convenience because it wishes to complete the Works itself or has found another contractor willing to complete the Works at a lower cost.

The 1999 RB, YB and SB permit the Employer to terminate at any time for the Employer's convenience by giving notice to the Contractor (clause 15.5). The Employer is however prohibited from terminating to execute the Works itself or to arrange for the Works to be executed by another. After termination under clause 15.5, the Contractor is to be paid in accordance with clause 19.6. Essentially this means that the Contractor is entitled to payment for all work carried out plus removal/repatriation costs but not lost profit.

Under clause 15.5 of the 2017 RB, YB and SB the Employer is no longer prohibited from terminating in order to execute the Works itself or to have others do so, although it may do this only after the Contractor has received payment of the amount due on termination. That amount is to be valued under a new clause 15.6 which makes it clear that the Contractor is entitled to loss of profit or other loss and damage suffered by the Contractor as a result of this termination. Clause 15.7 requires the Employer to pay the amount certified by the Engineer (RB and YB) or agreed or determined by the Employer's Representative (SB) within a defined period. Clause 1.14 (2017 SB) and clause 1.15 (2017 RB and YB) exclude liability for loss of profit and indirect loss (etc) but expressly do not apply to payment after termination for Employer's convenience. Therefore, the Employer may have unlimited liability to the Contractor for loss of profit or other loss or damage sustained by the Contractor as a result of such termination.

## Payment of DAB/DAAB decision

Much has been written about employers failing to pay sums awarded by the DAB under the 1999 RB, YB and SB.

In the 2017 editions, in which the DAB is replaced with the DAAB, the Contractor has the right under clause 16.1 to give notice and then reduce the rate or work or suspend work and under clause 16.2 to give notice of intention to terminate, if the Employer fails to comply with a decision of the DAAB *and* such failure also constitutes a material breach of the Employer's obligations under the Contract. The requirement that failure must also constitute a material breach presumably is intended to prevent suspension or termination for a failure to perform a trivial part of the contract. One can easily imagine parties disagreeing about whether a failure to pay a small sum awarded by the DAAB in the context of a very large overall contract price constitutes a material breach. Overall, however, these revisions are welcome because they should encourage parties to comply with DAAB decisions.

Further encouragement is given by clause 21.7 which permits a party to refer a failure by the other party to comply with a DAAB decision directly to arbitration without first obtaining a DAAB decision for that failure or going through the amicable settlement procedure. There is no requirement here that the failure to



comply with the DAAB decision also constitutes a material breach. The arbitral tribunal is given the power, by way of summary or expedited procedure, to order the enforcement of the DAAB decision. Again, this revision is welcome because it reinforces the binding status of a DAAB decision and the requirement that parties shall promptly comply with it.

## Conclusion

The FIDIC forms provide a range of protection and remedies to the Contractor in respect of Employer payment risks and failures. They include obligations on the Employer to provide information regarding its financial arrangements and they give the Contractor the right to reduce or suspend work or terminate if the Employer fails to provide reasonable evidence of those arrangements or pays late or fails to pay. The 2017 editions also entitle the Contractor to loss of profit if the Employer terminates the Contract for convenience and give rights to the Contractor if the Employer fails to pay a DAAB award. Ultimately, the Contractor's remedy for non-payment (including if the Employer is bankrupt or insolvent or similar) is termination but this is a drastic step with serious consequences which the Contractor should not take without first obtaining legal advice.

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