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FIDIC Contracts - An Overview

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FIDIC's 1999 Rainbow

The Red, Yellow, Silver and Green Books

An Overview

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FIDIC's 1999 Rainbow – An Overview of the Red, Yellow, Silver and Green Books

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Introduction

FIDIC launched their suite of 4 contracts in September 1999:-

- The Conditions of Contract for Construction (the Red Book)
- The Conditions of Contract for Plant and Design-Build (the Yellow Book)
- The Conditions of Contract for EPC Turnkey (the Silver Book)
- The Short Form of Contract (the Green Book)

The first comment to make is that the standard format of the three major forms is welcome. They all have 20 clauses, 17 common clause titles and much wording and many definitions and concepts in common. Although it may be thought that the desirability of this commonality has led the draftsmen into error with the Silver book, a suite of contracts such as these is a great improvement over the needless variations in the earlier forms. The Green Book has just 15 clauses covering 10 pages.

One effect of the 1999 issues is to make redundant the popular but troublesome Orange Book of 1995. The Yellow Book is in some ways the second edition of the Orange Book and is an improvement, in this writer's view. It is also intended to supercede the 3rd Edition of the Yellow E&M form, published in 1987.

The old Red form was for civil works and the old Yellow for E&M work. The 1999 forms divide as to responsibility for design, irrespective of the work type. The decision to divide the forms by design responsibility rather than work type is debatable. The UK Institute of Civil Engineers' New Engineering Contract demonstrates (as to a lesser extent does FIDIC's Short Form) that there is no fundamental difficulty in providing for contractor design as an alternative in a contract

form. Rather, it might be said the approach to an E&M or process plant contract is quite different to a civils contract. Nevertheless, the division is very likely to work in practice.

The decision to depart from FIDIC's traditional balanced risk philosophy may be viewed with alarm by some readers of the Silver Book. Should FIDIC be endorsing the practice of dumping risk on contractors? Of course it happens and for sufficient commercial reasons in projects with non- or limited recourse project financing where price certainty is considered paramount. But what will be the effect elsewhere in the market? If FIDIC say it is accepteble to place ground conditions risk on contractors in the Silver Book, how often will we see the Silver Book clause 4.12 replacing its equivalent in the Red and Yellow Books?

Common features

Employers and funders will be pleased to see the following new features in all three 1999 books:-

- Sample on-demand bonds are now included with the conditions, FIDIC having overcome its distaste for these instruments to recognise international practice.

- Progress reports are required by clause 4.21 and must be included with the supporting documents accompanying applications for payment – clause 14.3. The next step to payment occurs (clause 14.6)

  "*… within 28 days after receiving a Statement and supporting documents …"*

  thus making payment conditional upon receipt of the progress report.

- Termination for convenience is provided for at clause 15.5 upon 28 days' notice. The Contractor is paid for work done and demobilisation but receives no compensation.

- The Defects Notification Period, as it is now called, may be extended for up to 2 years

  "*… if and to the extent that the Works, Section or a major item of Plant … cannot be used for the purposes for which they are intended by reason of a defect or damage",* clause 11.3.

- Failure to provide claim notices within the 28 days provided by clause 20.1 means

> "*… 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."*

This contrasts with FIDIC policy hitherto which stopped well short of barring contractors' claims for lack of notice. Contractors may think that the 42-day limit for the response to the claims (clause 20.1) is scant compensation for the very real danger that this clause represents. One result may be the appearance on site of claims managers more frequently and at an earlier stage in the life of a project.

Contractors will be pleased to see the following in all three major contracts:-

- Force Majeure is broadly defined by clause 19.1 as an exceptional event or circumstance

> "*(a) which is beyond a Party's control, (b) which such Party could not reasonably have provided against before entering into the Contract, (c) which, having arisen, such Party could not reasonably have avoided or overcome, and (d) which is not substantially attributable to the other Party …"*

The normal list of examples is provided but the above definition may provide some surprises. Equally important are the consequences set out at clause 19.4, which are that the Contractor receives both time and reimbursement of costs that results from the event, a far cry from traditional *force majeure*.

- The ability for a Contractor to demand

> "*reasonable evidence that financial arrangements have been made and are being maintained which will enable the Employer to pay the Contract Price …"*, clause 2.4.

In view of the fact that failure to comply with Sub-Clause 2.4 is treated as a default by the Employer which by clause 16.1 entitles the Contractor to suspend all or part of the Works or

to terminate under clause 16.2, the issue of what is "reasonable evidence" of a future ability to pay could be hotly debated.

- Suspension for late payment and late certification under clause 16.1

- Financing charges compounding monthly for late payment at 3%

  "*above the discount rate of the central bank in the country of the currency of payment"*

  which provision (clause 14.8) may or may not provide an incentive for the Employer to pay promptly.

- Ground conditions claims are alive and well at clause 4.12 in the Red and Yellow Books with the proviso that a claim may be reduced where

  "*other physical conditions in similar parts of the Works (if any) were more favourable than could reasonably have been foreseen when the Contractor submitted the Tender."*

  Employers faced with ground conditions claims will no doubt be looking for reductions and the meaning of "similar parts" and "more favourable" will come under close scrutiny.

- The Employer must comply with a claims clause (Clause 2.5) and may not make arbitrary deductions from sums otherwise payable. Whereas a general right to set off from sums certified was preserved in previous forms, here the Engineer's determination function is intended to cover all the Employer's entitlements so that any attempt to set off could result in suspension or termination by the Contractor.

Construction lawyers will be pleased (or at least kept busy) by the extended use of the terms "reasonable" and "Unforeseeable", the latter term being defined at clause 1.1.6.8 in the Red and Yellow Books as

"not reasonably foreseeable by an experienced contractor by the date for submission of the Tender".

This formula plays its part in so many ground conditions disputes that its use now in relation to delay by Authorities (clause 8.5) and certain shortages of goods and labour (clause 8.4(d)) seems likely to keep the disputes industry active.

Equally, the term "reasonable evidence" of ability to pay, combined with the dramatic sanctions available to the Contractor who considers that such evidence has not been forthcoming, seems sure to be the subject of much debate. (A similar clause caused much trouble on a recent Asian project to this author's knowledge.) Nevertheless, the clause is right in principle in this writer's view, as any contractor caught up in a project in a collapsing economy will testify.

Generally welcome will be the replacement of the Engineer's decision with a Dispute Adjudication Board as the first step in the dispute process set out in clause 20. These Boards, which may be of one or three members, have proved their worth on a variety of projects and should substantially reduce the duration of disputes. Their decisions will have interim binding effect, unlike World Bank dispute review boards who make recommendations only.

> "*The decision shall be binding on both Parties, who shall promptly give effect to it unless and until it shall be revised in an amicable settlement or an arbitral award …"* Clause 20.4

Rules for the adjudication are provided in each form.

The Engineer in the Red and Yellow Books

The debate within FIDIC and beyond on the role of the Engineer appears not to be over and an uneasy compromise appears to have been reached. Clause 3.1(a) declares that

> "*whenever carrying out duties or exercising authority, specified in or implied by the Contract, the Engineer shall be deemed to act for the Employer."*

Clause 3.5 requires him to make "*a fair determination in accordance with the Contract, taking due regard of all relevant circumstances*" where the conditions refer to clause 3.5. The claims clause refers to clause 3.5; the payment and variations clauses do not. In the Silver Book, the Employer is also required to be fair in certain specific instances.

Fairness "in accordance with the Contract" is the standard that an arbitrator would be expected to apply in any dispute. This is regardless of whether clause 3.5 applies or not. What then is the message that is being sent about the conduct of a party where clause 3.5 does not apply? This commentator fears that a complaint of "unfair" by a contractor will be met with the response "we don't have to be" where clause 3.5 does not apply. Perhaps the obligation to be fair, as distinct from impartial, should have been stated as a general obligation wherever decisions have to be taken by the Engineer or Employer.

The Engineer may now be replaced by the Employer, subject to a right of reasonable objection by the Contractor "with supporting particulars" (clause 3.4). It will be interesting to see how this works in practice.

Risk Allocation in the Red and Yellow Books

As mentioned above, clause 12 lives on in clause 4.12 of these books, except that recovery may be reduced if more favourable conditions than could have been expected are encountered elsewhere in "similar parts of the Works". What is a similar part will inevitably cause difficulty.

Overall, the risk allocation has moved slightly in the contractor's favour. The definition of *force majeure* has broadened beyond the impossible or illegal basis of the Orange Book. Now it must be beyond a party's control, something against which he could not reasonably have provided and which he cannot now reasonably avoid or overcome and for which he cannot blame the other party. The illustrative list now includes

"natural catastrophes such as earthquake, hurricane, typhoon or volcanic activity".

The Contractor recovers time and money for such events.

The increased power of the Contractor in relation to the Employer's ability to pay and actual payment is a significant and entirely justified shift in commercial risk, in this writer's view. Financing charges and suspension for non-payment and suspension for late interim payment certificates all serve to increase the pressure on Employers to have their financing properly

organised or, where that is not possible, to relieve the Contractor from the obligation to work on regardless.

These beneficial moves for contractors are balanced to some extent by the termination for convenience option (clause 15.5) which provides no profit for the Contractor.

The potential severity of the 28-day notice provision for claims and the consequences of a failure to give the right notices and particulars represents a danger to the Contractor and may well have the undesirable consequences of shortening the project honeymoon, of increasing the claims staff on projects and causing disputes to arise early in the life of a project.

Red Book value engineering

One feature deserves special mention. There is a value engineering clause at clause 13.2 of the Red Book which gives the Contractor the opportunity and incentive to suggest cheaper or quicker ways of executing the project. The reward is 50% of the net benefit to the Employer, i.e. half the cost saving less any diminution in the value of the project. Thus a cheaper turbine may mean increased maintenance so the net benefit of the alternative may be less than the saving in capital cost.

Yellow Book features

In this lump sum form, the Contractor has to produce a result:

> "*When completed, the Works shall be fit for the purposes for which the Works are intended as defined in the Contract*" (clause 4.1).

This formula is similar to the old Orange Book and is not popular with contractors. How the purpose should be defined in the contract is and will remain a subject for debate.

FIDIC have tried to tackle the confusion in the Orange Book about responsibility for errors in the Employer's Requirements. Results are not good. The Contractor is supposed to state in his tender letter that he has "*ascertained that [the Employer's Requirements etc.] contain no errors or other*

defects". However, after commencement, clause 5.1 provides the Contractor with a set period to point out any other errors and time and money is awarded unless

> *"… an experienced contractor exercising due care would have discovered the error …before submitting the Tender."*

After the period has expired, any errors found later will give rise to time and money only if that experienced contractor would not have spotted the error in the initial prescribed period.

So who is responsible for errors in the Employer's Requirements? Well ..... it depends. Meanwhile, the fitness for purpose obligation remains regardless.

Silver Book features

This is intended as a turnkey form for BOT and other similar projects where the risk is placed largely on the Contractor. So clause 4.12 states that

> "*(b) by signing the Contract, the Contractor accepts total responsibility for having foreseen all difficulties and costs of successfully completing the Works"*

This is clear but there is an impossibility clause at clause 19.7 which discharges the Contractor from further performance

> "*if an event or circumstance outside the control of the Parties … arises which makes it impossible or unlawful for either or both Parties to fulfil its or their contractual obligations …".*

This provision may well come under pressure where ground conditions render the works impossible to achieve as intended.

The fitness for purpose formula in the Yellow Book appears in the Silver Book as well but errors in the Employer's Requirements are placed squarely at the door of the Contractor by clause 5.1 with certain exceptions, in particular the definitions of intended purposes and the performance criteria. The rest must be checked and adopted by the Contractor. It is less clear that the

Contractor is thus free to take or leave the Employer's Requirements to the extent that he believes that he can achieve the performance specification in another way.

Where the desire for similarity with the other forms may have led the draftsmen astray is the degree to which the Employer can interfere with the works and the Contractor's performance. This is making contractors reading this form uneasy. If the Contractor is to have so much risk and responsibility, it is felt that the Employer should leave the Contractor to progress the works and achieve the performance specification in his own way. The turnkey contract should not, perhaps, be used where the ability of the Contractor to achieve the result is so much in doubt that constant supervision is required.

The concept of turnkey in its pure form is that the Employer goes away entirely and returns when the Contractor has a completed project ready to meet the performance specification. This form seems to be a long way from that concept. Although the Employer has a legitimate interest to ensure that the stage payments being made are not being wasted, the ability to instruct, to vary and to condemn may go too far here. Responsibility for the result is not diminished if the Employer does choose to interfere and instruct how the work is to be done although the Contractor can record his objections to a variation under clause 13.1.

The test edition of the Silver book received a rocky reception from some quarters and some changes were made to address the concerns being raised. It is doubtful that the contracting community will be satisfied with the 1st Edition and may well fear that the form will be used outside of the true turnkey situation for which it was intended.

Short Form highlights

The Green Book started out as a minor works form but evolved, not least when dredging contractors said that large value but simple contracts for dredging and reclamation might also be appropriate for the form. It is contained in 15 clauses on 10 pages of large print, the task group having made every effort to keep the language and concepts simple.

- A similar overall risk philosophy has been adopted as for the Red and Yellow books.
- The contract price would normally be a lump sum

- Contractor's design is briefly catered for at clause 5, such design having a fitness for purpose obligation. The Employer retains responsibility for his Specification and Drawings.
- A combined Offer and Acceptance form of agreement is provided as a somewhat optimistic guide to good procurement practice.
- A long list of Employer's Liabilities gathers into one place (clause 6.1) all events that give rise to an entitlement to additional time and money
- An early warning provision (clause 10.3) replaces any specific sanction for failure to give notices.

> "*The Contractor entitlement to extension to the Time for Completion or additional payment shall be limited to the time and payment which would have been due if he had given prompt notice and had taken all reasonable steps.*"

- Early suspension for non-payment after 7 days' notice, clause 12.2.
- 8-week adjudication before a single adjudicator with interim binding effect, clause 15.

It is understood that there are no plans for a Red book sub-contract so it may be that the Short Form has a dual life as a subcontract. It should be said, however, that it was not drafted with this in mind and this writer, at least, has not worked out what pitfalls might exist in any attempt to use the form in that way.

Conclusion

FIDIC's 1999 rainbow of forms should be welcomed. There is little reason to doubt that the Red and Yellow forms will take their place on the international stage in the way that their predecessors have done. The World Bank has indicated its intention to incorporate the Red Book into its standard bidding documents and to permit the use of the Yellow Book on appropriate projects. They are also taking a keen interest in the Short Form for smaller contracts. The 1999 Rainbow therefore seems destined to have a major impact on the international construction industry.

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