

Time, Payment, Performance Bonds and Termination Under the 1999 FIDIC Red Book

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Introduction

Internationally, the FIDIC forms of contract are the most widely used standard forms for construction and engineering projects.² Whilst this success can be attributed to a number of factors, the most prominent is down to the support by the World Development Bank.³

In terms of FIDIC's history, the 1st Edition was published in 1957. The FIDIC 1st Edition was based upon the ACE form of contract which was itself based on the ICE 4th Edition (an English civil engineering contract).⁴ The FIDIC 2nd Edition was published in 1969. The 3rd Edition was issued in 1977, and the FIDIC 4th Edition was issued in 1987. In 1999 FIDIC published its 'Rainbow Suite' of contracts, which included, along with the FIDIC Red Book, the Yellow Book (Design and Build), the Silver Book (EPC) and the Green Book (Short Form). Other forms followed by way of the Red Book Subcontract (2002), the Pink Book (MDB) (2004), the Blue Book (Dredging) 2006 and the Gold Book (DBO) in 2008. In 2000 FIDIC published an extremely useful Contracts Guide.⁵

The Rainbow Suite was drafted to create a more balanced allocation of risk between the parties, though, of course, different forms of contract seek to allocate risk in differing proportions, e.g. the Silver Book shifts the majority of risk and responsibility onto the Contractor with little involvement by the Employer during the project execution phase. Users of the Pink Book will be aware of its subtle but important differences with the Red Book (e.g. sub-clauses 2.5, 3.1, 3.5, 4.2, 8.1, 12.3, 15.6, 17.6, 20.1 and 20.6).⁶

The FIDIC Red Book comprises a set of General Conditions (with 20 main clauses), Particular Conditions (prepared on a project-by-project basis) and an Appendix to Tender (which includes crucial contract data). Whilst FIDIC contemplates the execution of a formal Contract Agreement, the contract between the parties in the Red Book will actually be made by way of the issue of a Letter of Acceptance. In the Silver Book a contract is concluded by way of execution of a Contract Agreement.

Time

In terms of time, sub-clause 8.2 of the FIDIC Red Book makes it clear that the Contractor must complete the Works by the Time for Completion, the latter being stated in the Appendix to Tender. The Contractor's progress will be monitored against its baseline programme and any updated/revisions thereto.⁷ The Particular Conditions may prescribe the level of detail and format required of the Contractor's programme. Once it has started the Works the Contractor must then proceed with 'due expedition and without delay'.⁸ As part of its monthly reporting obligations set out in sub-clause 4.21, the Contractor must provide information on all matters likely to affect the progress of the Works so that all concerned parties can identify potential problems and deal with them accordingly.

If during the course of the Works the Contractor believes that it is entitled to an extension of time for one of the grounds listed in sub-clause 8.4 it is required to make a claim pursuant to sub-clause 20.1 within 28

days of becoming aware of the delay event.⁹ To the extent that the Engineer believes that the Contractor's progress is too slow to meet with the Time for Completion then, pursuant to sub-clause 8.6, the Engineer may issue a notice for the Contractor to speed up its rate of progress. The Contractor should be aware that failing to act upon a sub-clause 8.6 notice could ultimately lead to an Employer termination pursuant to sub-clause 15.2(c)(i).

Following receipt of a claim for an extension of time the Engineer is required to follow the process prescribed in sub-clauses 20.1 and 3.5 to make a 'fair' determination as to the Contractor's entitlement.¹⁰ To the extent that the Contractor is not awarded an extension of time then it will be liable for delay damages for the late completion of the Works pursuant to sub-clause 8.7. Difficulties often arise when the Contractor believes it has been wrongly denied an extension of time and is subsequently issued with a sub-clause 8.6 notice.

Ultimately, the Works will be complete when a Taking-Over Certificate has been issued under Clause 10.¹¹ Determining whether the Works are ready for taking over will be a matter of fact for the Engineer to decide on.¹²

Payment

In terms of payment, the FIDIC Red Book is a remeasurable contract. Whilst the payment process is briefly described below, it should be noted that if certain conditions are not met then the process can be derailed.

The Contractor will submit monthly applications (i.e. statements).¹³ The Engineer will, following an evaluation carried out pursuant to sub-clause 12.3, issue an Interim Payment Certificate within 28 days thereof¹⁴ and the Employer should make payment within a further 56 days.¹⁵ Within 84 days of the issuance of the Taking-Over Certificate the Contractor will submit its Statement at Completion¹⁶ and the Engineer will issue a Payment Certificate accordingly. 56 days after receiving the Performance Certificate the Contractor will submit its Application for Final Payment Certificate.¹⁷ To the extent that the Engineer agrees with this Application,¹⁸ the Contractor will issue its Final Statement for the agreed amount along with a written discharge¹⁹ following which the Engineer will issue a Final Payment Certificate. Importantly, if the Employer fails to pay on time against a certified amount then the Contractor will be entitled to finance charges,²⁰ and possibly to terminate.²¹

Clause 13 defines what will constitute a Variation and also prescribes how a Variation is to be dealt with and valued.

To the extent that the Contractor believes it is entitled to additional payment (there can sometimes be a dispute as to what is meant by 'additional') then it is required to make a claim in accordance with sub-clause 20.1. The time bar provision included within this particular sub-clause has been the subject of numerous articles over the years and its applicability in the UAE remains a hot topic.

The FIDIC Red Book caters for Provisional Sums, though such work will only be carried out if instructed by the Engineer.²²

Crucially from the Contractor's perspective (who may be tendering for large construction or engineering projects), sub-clause 14.2 allows for an Advance Payment to be made. The Contractor will be required to provide a guarantee for this Advanced Payment and the Employer will claw this money back incrementally via interim payment certificates.

An often overlooked provision of the FIDIC Red Book is the ability of the Contractor to request that the Employer provides reasonable evidence of its financial arrangements. During periods of economic downturn this could be a useful tool for the Contractor. Contractors should be wary of an Employer who wishes to have this sub-clause deleted.

Performance Bonds

Ever since the global financial crisis hit Dubai in late 2008 there has been a propensity for calls to be made against 'on-demand' Performance Bonds ('PB').

Sub-clause 4.2 provides (paraphrasing) that a Contractor must provide a PB within 28 days of receiving the Letter of Acceptance, usually for 10% of the Accepted Contract Amount.

Sub-clause 4.2 prescribes the circumstances under which an Employer may make a demand on the PB: (i) a failure by the Contractor to extend the period of validity of the PB; (ii) a failure by the Contractor to pay an amount due to the Employer; (iii) failure by the Contractor to remedy a default; and (iv) where the Employer has grounds to terminate (importantly, the Employer need not actually terminate).

The sub-clause itself is silent as to what form a PB should take and that is a matter of separate negotiation but the FIDIC Red Book does provide a template. The wording of the PB itself needs to be carefully considered because the agreed version may actually contain pre-conditions to making a demand. The FIDIC template includes optional wording that the PB will expire upon the issuance of a Taking-Over Certificate; however, it is quite usual in the UAE for the period of validity of the PB to be extended through to the issuance of a Performance Certificate.²³ Difficulties for the Contractor often arise when a Performance Certificate is never issued or there is no fixed period for the PB.

However, and quite often in the UAE, the Employer often forgets (or ignores) that it has a duty to account for the monies called under a PB. The Employer would do well to remember the penultimate paragraph of sub-clause 4.2 whereby the Employer provides the Contractor with an indemnity for any claim made on the PB which it was not entitled to make. In practice, if the Employer makes a call for the full amount of a PB during the Defects Notification Period when it has already taken over the Works and is operating the same for its intended purpose, the Contractor will often seek to rely on arguments under the UAE Civil Code to challenge the validity of the call, including, amongst other things, that the demand was an unlawful exercise of a contractual right (Article 106) or made contrary to good faith (Article 246(1)).

Given the importance of this issue, the process and implications of making a call on the PB are considered in more detail below.

Firstly, the Employer will make a demand on the bank which provided the PB. For tactical reasons this demand is often made so that the bank has as little time as possible to inform the Contractor, and at an inconvenient time so that the Contractor struggles to engage lawyers to prevent the bank from paying out on the PB.

Notwithstanding that a call on the PB has been made and that it should be paid out immediately it can sometimes take up to 2 or 3 weeks for a bank to release the money.

Once it has been notified by the bank that the Employer has made a call on the PB the Contractor will almost certainly apply for an attachment order (the equivalent of a freezing order injunction).²⁴ The Contractor's application is made *ex parte*. It is quite usual for the attachment to be granted at this first *ex parte* hearing.²⁵ Often, the first time the Employer becomes aware of the attachment is when it receives notice that its bank account has been frozen.

Once the attachment has been granted the Contractor is required to commence proceedings for the main dispute within 8 days of the attachment,²⁶ and if it does not do so the attachment will be dismissed.²⁷ However, the commencement of proceedings for the main dispute within this 8 day period can be problematic for the Contractor if the main contract includes for arbitration and there are pre-conditions to commencing arbitration (e.g. a dispute first has to be referred to a Dispute Adjudication Board).

At the first *inter partes* court hearing after the Contractor has filed a claim for the main dispute the court will normally join the attachment order proceedings to the main proceedings.

As one would expect, and so as not to undermine the status of bonds in the international banking

community, the *inter partes* court hearing will usually, though not always, result in the lifting of the attachment. The court will generally take the view that the issue of whether the PB was properly called is a matter to be decided as part of the main dispute.

Termination

The termination of a construction contract which is subject to the FIDIC Red Book is far from straightforward in the UAE because of the interface between the contractual termination provisions and what local law provides for in respect of termination.

At the outset, one would do well to remember some important provisions of UAE law. Firstly, Article 2(1) of the UAE Commercial Code provides a hierarchy of laws whereby the contract comes first, followed by the Commercial Code, then custom and practice and then the provisions of the UAE Civil Code. Secondly, Article 31 of the UAE Civil Code provides that a mandatory provision of law will take precedence over any conflicting contractual provision. Therefore, mandatory provisions of UAE law, along with others, need to be carefully considered when contemplating a termination under the provisions of the FIDIC Red Book.

Clauses 15 and 16 set out the contractual grounds for termination in the event of default by the Contractor or Employer respectively (sub-clause 15.5 allows the Employer to terminate for convenience). In short, provided the relevant grounds exist and, in some instances, the appropriate notices have been issued, the aggrieved party may serve a 14-day notice on the other party to terminate.

That all sounds relatively straightforward. However, the problem lies in how these contractual provisions sit with UAE law.²⁸

Article 267 of the UAE Civil Code provides that a contract can only be terminated in one of three ways: (i) by consent; (ii) by order of the court (or tribunal); or (iii) by a provision of law.²⁹ This last provision is generally taken to mean (in a construction setting) a force majeure type event as prescribed in Article 273 of the UAE Civil Code.³⁰ It is the first two provisions which create issues in the context of a termination under the FIDIC Red Book.

The first type of termination, i.e. by consent, sometimes gives rise to the argument that when the parties negotiated and signed the contract they thereby agreed (consented) that either party would be able to terminate the contract if the grounds for termination were met, such that a court order for termination is not needed and termination takes effect immediately. However, the contrary view to this argument is that such agreement can only take place when the termination itself is contemplated. The least risky challenge to a termination by consent is to ensure that the contract expressly includes a provision that a termination can be made without the need for a judicial order, which would make the termination compliant with Article 271 of the UAE Civil Code.

The second way of terminating a contract under UAE law is by way of a court (or tribunal) order pursuant to Article 272 of the UAE Civil Code, but there are pre-conditions to be met if a termination under this provision is to be lawfully effected.³¹ Indeed, what will often happen when terminating under the FIDIC Red Book is that the terminating party will seek to rely upon its contractual default and termination notices as Article 272 compliant notices.

One can foresee the potential issues that may arise. On the one hand a party may terminate a contract in real time under FIDIC but, under UAE law, the contract may be said to remain in existence until a court (or tribunal) declares the contract terminated.³² Some lawyers may argue that the contractual termination under FIDIC gives rise to a 'determination', i.e. it is only the primary obligation of performance which has been ended, but the ancillary secondary obligations remain intact. However, a UAE court may well take a more broad-brush approach and simply ask itself whether a party is seeking to argue that a contract has been terminated, yes or no. Furthermore, the local courts have previously decided that upon a termination a party's ancillary rights (e.g. liquidated damages) fall away, which is inconsistent with the termination provisions of FIDIC.

Ultimately, no matter what the parties argue or their lawyers advice, it will be for a court (or tribunal) to decide whether the termination was lawful.

Summary

The perennial problems surrounding time, payment, performance bonds and termination have carried across from the use of the FIDIC 4th Edition through to FIDIC's 1999 Rainbow suite and there is no reason to suggest that they will disappear when FIDIC introduces its updated standard form contracts. With this in mind, and given that the UAE's construction industry has now experienced its first boom-bust cycle, maybe it is time that the industry's players started looking at more collaborative approaches to contracting and consider using other industry standard forms such as the NEC3.

Footnotes:

¹*Federation International des Ingenieurs-Conseils*, Conditions of Contract for Construction for Building and Engineering Works designed by the Employer, 1st Edition (1999)

²Baker E, Mellors B, Chalmers S, Lavers A, *FIDIC Contracts: Law and Practice*, Informa (2009) p1

³Mason J, *Construction Law: From Beginner to Practitioner*, Routledge (2016) p170

⁴Baker E, Mellors B, Chalmers S, Lavers A, *FIDIC Contracts: Law and Practice*, Informa (2009) p4

⁵*The FIDIC Contracts Guide*, FIDIC (2000)

⁶The Pink Book is a special version of the Red Book whereby FIDIC conferred a license to amend its General Conditions to suit the MDBs.

⁷Sub-clause 8.3 FIDIC Red Book

⁸Sub-clause 8.1 FIDIC Red Book

⁹In the recent case of *Obrasconv. AG for Gibraltar* [2014] EWHC 1028 (TCC) the Court considered the issues surrounding a sub-clause 20.1 in some detail.

¹⁰There is some discrepancy as to at what stage the Engineer is to follow sub-clause 3.5 when dealing with a claim under sub-clause 20.1.

¹¹Note that sub-clause 10.1 allows for a deemed taking-over and sub-clause 10.2 allows for a partial taking-over.

¹²Baker E, Mellors B, Chalmers S, Lavers A, *FIDIC Contracts: Law and Practice*, Informa (2009) p241

¹³Sub-clause 14.3 FIDIC Red Book

¹⁴Sub-clause 14.6 FIDIC Red Book

¹⁵Sub-clause 14.7 FIDIC Red Book

¹⁶Sub-clause 14.10 FIDIC Red Book

¹⁷Sub-clause 14.11 FIDIC Red Book

¹⁸The Contractor and Engineer are required to discuss matters to see what can be agreed. If all items cannot be agreed upon then the Engineer should issue an interim payment certificate for those items not in dispute.

¹⁹Sub-clause 14.12 FIDIC Red Book

²⁰ Sub-clause 14.7 FIDIC Red Book

²¹ Sub-clause 16.2(c) FIDIC Red Book

²² Sub-clause 13.5 FIDIC Red Book

²³ Sub-clause 11.9 FIDIC Red Book refers

²⁴ Article 252 of Federal Law No.11 of 1992 (The UAE Civil Procedures Law)

²⁵ Article 259 UAE Civil Procedures Law

²⁶ Article 255(2) UAE Civil Procedures Law

²⁷ Dubai Court of Cassation Judgment 322/94

²⁸ One would do well to remember that the UAE Civil Code was implemented well before the explosion of mega building projects in Dubai and the proliferation of using complex standard form construction contracts.

²⁹ These grounds for termination are somewhat mirrored in Article 892 of the Muqawala provisions of the Civil Code. Whilst not expressly provided for in the UAE Civil Code, there is case law which suggests that an Employer may terminate for convenience but in doing so it will be liable to pay the Contractor for, amongst other things, its loss of profit.

³⁰ This is mirrored by Article 893 of the Muqawala section of the Civil Code

³¹ This is mirrored by Article 877 of the Muqawala section of the Civil Code

³² Grose M, *Construction Law in the United Arab Emirates and the Gulf*, Wiley Blackwell (2016) p186