

# Clause 2

## Summary

**Clause 2 sets out certain obligations which are imposed on the Employer; however, this is by no means all the Employer's obligations. The obligation to pay the Contractor, for example, is found in Sub-Clause 14.7 and the obligation to Take-Over the Works is found at Sub-Clause 10.1. The first obligation imposed on the Employer under this Clause is to give to the Contractor a right of access. Sub-Clause 2.1 needs to be read alongside Sub-Clauses 2.3 and 4.6, which make it clear that possession of the Site need not be exclusive.**

**Sub-Clause 2.2 imposes on the Employer an obligation to assist the Contractor when requested to obtain permits, licences or approvals required by the laws of the Country. The obligation to reasonably assist is not an absolute obligation and generally will not mean the Employer will have to expend money on fulfilling the obligation. Sub-Clause 2.3 imposes on the Employer an obligation similar to that imposed on the Contractor under Sub-Clause 4.6. The Employer is responsible for any failure by its personnel to co-operate with the Contractor or to comply with safety regulations, take care of persons on Site, make sure the Site is reasonably free from unnecessary obstructions, and protect the environment.**

**Sub-Clause 2.4 imposes on the Employer an obligation to show that financial arrangements have been made and are in place to enable it to pay the Contract Price. Sub-Clause 2.5 deals with the Employer's Claims and requires that the Employer give notice and particulars of its claim before the Engineer makes a Determination under Sub-Clause 3.5. The Employer cannot set-off any claims it may have against the Contractor unless it complies with this Sub-Clause.**

## Origin of clause

Sub-Clause 2.1 of FIDIC 1999 is similar to clause 42.1 and 42.2 of the 4<sup>th</sup> edition. There was also a similar provision within the 3<sup>rd</sup> edition. Sub-Clause 2.2 of FIDIC 1999 is similar to clause 54.3 and 54.4 of the 4<sup>th</sup> edition. Once again there were similar provisions within the 3<sup>rd</sup> edition. Sub-Clause 2.3 of FIDIC 1999 is based on clause 19.2 of FIDIC 4<sup>th</sup> edition. Sub-Clause 2.4 and 2.5 are new.

## Cross-references

Reference to Clause 2 is found in the following clauses:-

Sub-Clause 4.2	Performance Security
Sub-Clause 4.19	Electricity, Water and Gas
Sub-Clause 4.20	Employer's Equipment and Free-Issue Material
Sub-Clause 4.21	Progress Reports
Sub-Clause 7.5	Rejection
Sub-Clause 7.6	Remedial Works
Sub-Clause 8.6	Rate of Progress
Sub-Clause 8.7	Delay Damages
Sub-Clause 9.4	Failure to Pass Tests on Completion
Sub-Clause 11.3	Extension of Defects Notification Period
Sub-Clause 15.4	Payment after Termination
Sub-Clause 16.1	Contractor's Entitlement to Suspend Work
Sub-Clause 16.2	Termination by Contractor
Sub-Clause 18.1	General Requirements for Insurances
Sub-Clause 18.2	Insurance for Works and Contractor's Equipment

### **Sub-Clause 2.1 - Right of Access to the Site**

Although it is headed "Right of Access to the Site" this Sub-Clause deals with three subjects - access to the Site, possession of the Site and, separately, with possession of foundations, structures, plant or means of access. Different rules apply to each category.

#### Access to and possession of the Site

These two subjects are dealt with together in the Sub-Clause

The definition of Site (see Sub-Clause 1.1.6.7) is very broad. It includes

- the place where the Permanent Works are to be carried out. In certain circumstances Permanent Works carried out by one Contractor may be the Site for the following contractor (for example in a hydro-electric dam, the Engine room will provide the Site for the installer of the turbines);
- the place to which Plant and Materials are to be delivered; and
- other places which are to be considered part of the Site. Common examples are borrow areas, storage areas for materials, site offices and staff accommodation.

The Sub-Clause provides two different means of defining when the Employer is obliged to give the Contractor access to, and possession of the Site.

The first method of defining the Employer's obligation is by reference to specific dates stated in the Appendix to Tender. If this approach is not used the right of access

to or possession of the Site is to be given at such times as are necessary to enable the Contractor to proceed in accordance with the Sub-Clause 8.3 Programme.

Sub-Clauses 4.13 and 4.15 (see separate commentary) provide for responsibility for paying for and maintaining access.

#### Possession of Foundations, Structures, Plant Or Means Of Access

The timing is required to be in accordance with the Specification. The Sub-Clause is not clear that in the absence of a reference to the timing in the Specification the timing should be such as to enable the Contractor to proceed in accordance with the Programme because the Sub-Clause only refers to a right to be given access to or possession of the Site and not the area below the surface of the Site where the foundations are to be built. However, in our opinion, where no timing is set out in the Specification then the Employer must give possession in accordance with the Programme. Under English law, at least, possession of the Site would include both the ground beneath the land as well as the lower stratum of airspace above.<sup>1</sup>

It is not clear why the Sub-Clause requires possession of foundations etc. to be timed in accordance with the Specification and the Site in accordance with the Appendix to Tender. It would be sensible to amend the Sub-Clause to require possession and access to be according to the Appendix to Tender or alternatively in accordance with the Programme in both cases.

The last sub-paragraph of Sub-Clause 4.6 [*Co-operation*] is here relevant because it requires the Contractor to make a timely submission of any documents necessary to enable the Employer to provide the foundations etc. in accordance with the Specifications.

Where the right of access or possession is required to be given in accordance with the Programme, the Employer needs to be aware that the Contractor has the right to submit a revised programme under Sub-Clause 8.3 whenever the previous programme is inconsistent with actual progress or the Contractor's obligations. The Engineer and the Employer have no right to reject a revised programme if it is provided in these circumstances unless it does not comply with the Contract. Thus it is possible that the Employer will find itself in a position of having to provide possession or access earlier than it had originally planned. If the Employer is unable to provide possession or access, the Contractor may then have a right to an extension of time and monetary compensation.

It is possible that after the Contractor has been given access to or possession of the Site, it later loses it. The Sub-Clause makes it clear that the right is not exclusive – it

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<sup>1</sup> *Grigsby v Melville* [1974] 1 WLR 80

is possible that other contractors are also working on the Site or that others have access for reasons unrelated to the Contract. This is particularly likely to be the case where the Site includes areas which are only to be used for delivery or where they are not part of the Permanent Works or where the works involve the rehabilitation of an existing road or railway which must still be operated. Where works are controversial they may be occupied by protestors or local inhabitants who having been paid to leave may decide to return. In some circumstances there may even be criminal occupation; although this may amount to a *force majeure* event. On its own the Sub-Clause is not clear as to whether the risk of such interference is the responsibility of the Employer or of the Contractor.

On one reading of the Sub-Clause the obligation to provide access and possession is a once only event (“The Employer shall give ... right of access ... within the time stated...”). However this reading would not achieve the object of the Sub-Clause which must be to ensure that the Contractor has the access it needs in order to carry out the Works. If the Employer had the right to take possession away at any time this object would be defeated. It is reasonable therefore to conclude that the Employer’s obligation is to give access and possession and to ensure that that access and possession continues throughout the period of the Contract. It can therefore be said that, in the absence of express provision in the Contract, the Employer’s obligation to provide access and possession is a continuing one.<sup>2</sup> This interpretation also accords with Sub-Clause 10.2 where if the Employer uses part of the Works, except on a temporary basis, he is deemed to have taken it over. However the Contractor has several express obligations as follows:

- Under Sub-Clause 4.6, the Contractor is required to provide appropriate opportunities for others to carry out work.
- Under Sub-Clause 4.8, the Contractor is obliged to use reasonable efforts to keep the Site and Works clear of unnecessary obstruction to avoid danger and to provide fencing, lighting, guarding and watching of the Works.
- Under Sub-Clause 4.13 the Contractor is obliged to bear the costs of rights of way he may require including for access to the Site.
- Under Sub-Clause 4.14 the Contractor is obliged not to interfere unnecessarily or improperly with access to and use and occupation of roads and footpaths.
- Under Sub-Clause 4.15, the Contractor is obliged to keep access routes in good condition.
- Under Sub-Clause 4.23 the Contractor is obliged to keep the Site free of unnecessary obstruction.

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<sup>2</sup> See *HW Nevill (Sunblest) Ltd v William Press & Son Ltd* (1982) 20 BLR 79 at 87 where the court held: “Although Clause 21(1) uses the word “possession”, what it really conferred upon William Press was the licence to occupy the site up to the date of completion. On completion that licence came to an end.”

Of these Sub-Clauses, 4.8 and 4.23 are qualified (“reasonable” and “unnecessary”). If despite such reasonable efforts as are required under Sub-Clause 4.8, the Contractor was unable to achieve his obligations under this Sub-Clause the risk would fall back on the Employer.

So far as the Contractor’s obligations regarding the Site are concerned, the general effect is to place the obligation on the Contractor to take responsibility for access and occupation of the Site. This is relatively straightforward where there is only one Contractor on the Site. It would probably be only a blatant interference by the Employer with the Contractor’s use and occupation of the Site which would put the Employer in breach of the right of continuing occupation under Sub-Clause 2.1.

However, on large Sites where there is more than one Contractor working for the same Employer, there is great room for confusion and for conflicting needs and rights between the various contractors. If a contractor working on one part of the Site and otherwise doing exactly what it is required to do under its contract destroys part of the access needed by another contractor, who takes responsibility? The answer is found in Sub-Clauses 17.3 and 17.4 where loss or damage to the Works caused by the use or occupation by the Employer, except as may be specified in the Contract, is an Employer risk event.

Or if another contractor, in breach of its obligations under Sub-Clause 4.23, uses an area of the Site of which the first contractor needs possession as a storage area for unused materials, what happens? What would happen if, in breach of its obligations under Sub-Clause 4.6, one of the contractors fails to co-operate with one or more other contractors, thus limiting the extent to which they can get the benefit of access to and possession of the Site?

Sub-Clause 2.3 puts responsibility for lack of access or possession onto the Employer, by stating expressly that the Employer must use its power to enforce the contractual obligations of the other contractors. If the Employer (deliberately or not) does not enforce all contractors’ obligations to allow others to have access to and possession of the Site, it will be obliged to grant extensions of time and financial compensation to the others who suffer thereby. Logically the same should apply where one contractor who is in serious delay – whether for reasons which entitle it to an extension of time or not – causes disruption to the activities of the other contractors on site because it prevents them taking possession of completed parts of the works which they may need access to in order to meet their own programmes.

### Remedies

Where the Employer fails to meet its obligations under this Sub-Clause the Contractor must comply with Sub-Clause 20.1 and has a right to an extension of time and payment of Cost plus reasonable profit. A serious breach which has the effect of

stopping the Contractor working effectively could well form the basis of a Contractor's termination under Sub-Clause 16.2(d).

### **Sub-Clause 2.2 - Permits, Licences or Approvals**

This Sub-Clause requires the Employer to provide the Contractor with rather limited assistance in obtaining copies of laws and obtaining permits and then only at the request of the Contractor. The obligation is heavily qualified in that the Employer is only required to provide the assistance "where it is in a position to do so". Since the Contractor only has the right to ask for "assistance" and (in respect of copies of Laws) only for what "is not readily available" this Sub-Clause is not intended to help the Contractor unless he cannot help himself. What might put the Employer in the position of not being able to assist is not clear. Nor is there any obligation on the Employer to have people on its staff that are capable of assisting in this way.

Thus a locally based or government Employer may be better placed to provide such assistance than the (possibly foreign) Contractor but will not necessarily be so.

The Contractor would be unwise to rely on its Employer's assistance because, even if the Employer does not assist it, the Contractor is still obliged to obey the laws and to obtain the permits. In other words it really has no choice except to find out what laws may apply and what permits it needs.

It should be noted that the obligation only relates to Laws and permits of the Country in which the Works are being carried out, yet under Sub-Clause 1.13 the Contractor is obliged to obey applicable Laws (which may be those of other countries if part of the Works are performed outside the Country where the main Permanent Works are being carried out). The same applies to permits.

The Sub-Clause does not include any sanction against an Employer who fails to provide assistance requested and required by the Contractor. If the failure to assist causes delay, the Contractor may be entitled to an extension of time under Sub-Clause 8.4(e) – it would probably be considered a delay, impediment or prevention by or attributable to the Employer. Sub-Clause 8.5 gives the Contractor an entitlement to an extension of time where delay is caused by an authority delaying or disrupting its work. Arguably this would include delays caused by late issue of permits. However the Sub-Clause only takes effect if the Contractor has "diligently followed the procedures laid down by the relevant legally constituted public authorities ...". If the problem is that, as a result of a failure by the Employer to respond to a request for assistance under Sub-Clause 2.2, the Contractor does not know what these procedures are, it will be difficult to blame the public authority for the delay. Neither Sub-Clause 8.4(e) nor Sub-Clause 8.5 expressly gives the Contractor the right to any monetary compensation for the delay or disruption caused. However a breach of Sub-Clause

8.4(e) by the Employer would be a breach of contract and the Employer would be liable for the damages caused by its breach.

Employers sometimes demand payment for assistance under Sub-Clause 2.2. The Sub-Clause is silent as to whether or not Contractors must pay. In our opinion it is doubtful that there is a liability and the Employer's obligation to assist is part of its contractual obligations.

### **Sub-Clause 2.3 – Employer's Personnel**

The heading of this Sub-Clause is very misleading as it is not so much about Employer's Personnel as about the Employer's responsibility for making sure that they and other contractors on Site abide by their contractual obligations.

Employer's Personnel are defined in Sub-Clause 1.1.2.6 as including the Engineer, his delegated staff and all other employees of the Employer and the Engineer. In addition the Employer is entitled to designate any other people as Employer's Personnel. Sub-Clause 1.1.2.6 appears to have been drafted so as to avoid including other contractors working on the Site within the definition of Employer's Personnel. It probably achieves this object. Sub-Clause 2.3 focuses on two areas in which it makes it clear that the Employer's Personnel (who most importantly include the Engineer) and the Employer's other contractors on the Site must co-operate with the Contractor.

These two areas are the limited co-operation obligations which the Contractor has under Sub-Clause 4.6 (see discussion under Sub-Clause 4.6) and some of the safety and environment protection obligations under Sub-Clauses 4.8 and 4.18.

The wording of the Sub-Clause is rather odd in that it imposes an indirect rather than a direct obligation on the Employer. The Employer itself is not responsible for complying with the obligations under the two Sub-Clauses but it is responsible for ensuring that its Personnel and the other contractors comply. The result however should be the same because the Employer's Personnel will often only be able to comply if they make use of the Employer's powers to enforce its contracts. Moreover, on normal principles of law, an Employer will be responsible for the actions of its employees and contractors.

The way in which the Sub-Clause is worded means that if the Contractor finds that the Engineer is not as active as he ought to be in enforcing the co-operation, safety and environment obligations of other contractors, he will be able to insist that the Employer require the Engineer to act appropriately.

The Sub-Clause makes it imperative that all contractors on Site be employed under FIDIC conditions or at least under conditions which contain provisions similar to Sub-Clauses 4.6, 4.8 (a)(b) and (c) and 4.18 and that the Engineer's and other consultants'

terms of employment also contain equivalent terms. In the absence of such obligations in other contracts, the Employer may be unable to meet its obligations under this Sub-Clause.

One of the implications of this provision is that the Employer will be responsible if the behaviour of other contractors delays or disrupts the Contractor or prevents the Contractor having access to or possession of the Site (see commentary under Sub-Clause 2.1).

The obligations under Sub-Clause 4.8 (a) (b) and (c) include those related to complying with safety regulations and generally caring for the safety of those on Site, but also keeping the Site and Works clear of obstructions which might endanger people. Thus if the Site is in a bad state as a result of neglect by the Employer, the Engineer or other contractors, the Contractor may have a claim – either for the cost of doing what others were responsible for, or for delay or disruption caused as a result.

Similarly, under Sub-Clause 4.18, if the pollution or noise caused by other contractors is interfering with its ability to carry on its own part of the Works, the Contractor may have the right to claim.

There is a direct link between this Sub-Clause and the right to an extension of time under Sub-Clause 8.4(e) – “any delay, impediment or prevention caused by or attributable to the Employer, the Employer’s personnel, or the Employer’s other contractors on the Site”. There is no express right for the Contractor to receive Costs or profit but, to the extent it can prove a loss as a result of the Employer’s failure to meet its obligations under the Sub-Clause it should be entitled to damages for breach of contract.

#### **Sub-Clause 2.4 – Employer’s Financial Arrangements**

This innovative provision is intended to give some protection to the Contractor against Employer insolvency and the Employer’s inability to obtain funds to pay for a project. It is not a full substitute for other protective measures such as bank guarantees or substantial advance payments. However it is often difficult to persuade Employers to agree to such measures and Sub-Clause 2.4 is a valuable second best arrangement.

The Sub-Clause contains two requirements. The first is an obligation to demonstrate to the Contractor, when it requests it that the Employer has adequate funding to continue paying for the Works. The second obliges the Employer to notify the Contractor if it intends to make any material change to its financial arrangements.

#### Employer’s Ability to Pay the Contract Price



The Contractor is entitled, as often as it likes, to make a request for reasonable evidence that the Employer has made financial arrangements which will enable it to pay the Contract Price and other payments when they fall due.

What will constitute “reasonable evidence” and what financial arrangements will “enable the Employer to pay the Contract Price” will depend on the circumstances. In the recent case of *NH International (Caribbean) Ltd v National Insurance Property Development Company Ltd (Trinidad and Tobago)*<sup>3</sup> the Privy Council had to consider this provision of the Contract. In this case the Contractor requested evidence and the Employer sent a letter from the Project Administration Unit of the Ministry of Health (“the Ministry”), which advised that the Cabinet of the Government of Trinidad and Tobago had approved additional funding for the project in the sum of \$59.1m. The project costs were estimated by the Contractor at \$286,992,070.

Despite getting further assurances from the Government that (a) the Government would stand behind the project; (b) that \$224,129,801.99 would be made available; (c) that interim certificates would be paid, the arbitrator found that the Employer was unable to show that funds had been approved which would cover the whole of the project. The arbitrator held: (a) that the letters and evidence regarding funding did not amount to such “reasonable evidence” that “financial arrangements” had been “made and maintained”; and (b), if they did, then the sum was too low. The arbitrator therefore concluded that the Contractor was entitled to terminate the contract under Sub-Clause 16.2. The decision was upheld at first instance but was then set aside by the Trinidad and Tobago Court of Appeal. The Privy Council reinstated the arbitrator’s decision holding that this was an issue of fact, rather than law, and that the Court of Appeal was wrong to impose its own decision, when the parties had agreed on arbitration.

However, on one point the Privy Council agreed with the Court of Appeal and this related to the question that if there was reasonable evidence then could the Contractor have terminated if the amount available to the Employer was below the Contractor’s estimate of the Contract Price (item (b) above).<sup>4</sup> The Court of Appeal held (as approved by the Privy Council) that it was for the Contractor to prove the Contract Price.

This Sub-Clause will therefore be particularly significant in the context of project financed or aid funded projects. In the case of project finance, the project company is unlikely to have any significant resources of its own and will be dependent on the drawing down of the loans it has arranged. Such draw-downs may be jeopardised if the project company is in breach of its banking covenants. This can happen, for example where the project is one involving development of residential units and the

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<sup>3</sup> [2015] UKPC 37

<sup>4</sup> *Ibid* at para 34

advance sales are inadequate to meet the project's cash-flow requirements. Aid funded projects are less subject to risk of funding failure but the Contractor will want to be reassured of continuing adequate funding when, for example, there is a substantial variation or where a substantial claim threatens to put the project over budget.

In some circumstances it may be reasonable for the Contractor to insist on seeing copies of contractual documents confirming the Employer's right to continuing funding. In the case of government funded projects it would be reasonable to ask for evidence that the promoting department or government agency has been allocated sufficient funding to pay for the project. It may also be impossible to judge whether the arrangements are satisfactory without knowing what other commitments the Employer has and how it intends to meet them.

#### Material Change to Financial Arrangements

This paragraph imposes an obligation for the Employer to give notice where it intends to make any material change to its financial arrangements. While this is theoretically a useful protection to the Contractor it does not go far enough because it only refers to a change which the Employer intends to make. If the Employer is in financial difficulties or where its funders appear to be about to cut off funds, it is under no obligation to tell the Contractor. The Employer has no intention of changing anything – it is simply being put in a position where it may not be able to pay its bills as a result of its actions or the actions of others. The Sub-Clause would be far more use to the Contractor if, instead of saying "...if the Employer intends to make any material change to his financial arrangements ..." it said "...if the Employer is aware of any likelihood of material change to his financial situation ...".

The Employer is entitled to wait to the last moment before making any change to its financial arrangement. If the Employer gives the Contractor notice of its intention, the Contractor has little he can do with it. If he considers that the new intended financial arrangements are inadequate to enable the Employer to meet its financing obligations, the only course open to it will be to request evidence of the financial arrangements the Employer intends to make – a rather silly situation since the Contractor will just have received this situation. Then, 21 days after receiving the (unsatisfactory) information it will have the right to suspend. The Sub-Clause would make more sense if the Contractor was entitled to suspend 21 days after receipt of the details of the new financial arrangements, should they be unsatisfactory.

#### Enforcement

The Sub-Clause links with Sub-Clauses 16.1 [*Contractor's Entitlement to Suspend Work*] and 16.2 [*Termination by Contractor*]. The right to suspend (which includes a right to slow the rate of work) only takes effect 21 days after the Employer has failed

to respond in a satisfactory way. This means a delay of 49 days before the Contractor has any remedy. Although this seems a long time it is in fact a shorter time than the 56 days the Contractor is required to wait for payment after submitting its application for payment (Sub-Clause 14.7), and much shorter than the 77 days (the same 56 days plus 21 days notice under Sub-Clause 16.1) before the Contractor is entitled to suspend for non payment. It means that when the Contractor knows that the Employer may be in financial difficulties it does not need to wait for a missed payment before having a right to suspend.

However the proof of the Contractor's entitlement to the remedy may be difficult because there is a great deal of room for argument as to what is "reasonable evidence" and this makes it risky for the Contractor to suspend. As stated in *NH International (Caribbean) Ltd v National Insurance Property Development Company Ltd (Trinidad and Tobago)*<sup>5</sup> this is a question of fact for the arbitrator and therefore what can amount to reasonable evidence for one arbitrator may be considered unreasonable for another. Any such suspension will expose the Contractor to the risk of termination (for failing to progress the Works) if his suspicions prove not to be well-founded.

The equally risky process to termination takes a maximum of 84 days because the Contractor must wait for 28 days for the response (Sub-Clause 2.4), then give not less than 21 days notice of suspension (Sub-Clause 16.1) and finally wait 42 days after serving the suspension notice (Sub-Clause 16.2(a)) before giving 14 days notice of termination (second to last paragraph of Sub-Clause 16.2). Once again this seems a long time, but it is much shorter than the 112 days (the 56 day payment period under Sub-Clause 14.7, the additional 42 days under Sub-Clause 16.2(c) and the 14 day notice period under Sub-clause 16.2) that the Contractor has to wait before terminating for non-payment if the Employer is in difficulties.

### **Sub-Clause 2.5 – Employer's Claims**

Sub-Clause 2.5 is a new clause and did not appear in the FIDIC 4<sup>th</sup> edition. This clause is particularly important because it prevents the Employer, except in limited circumstances (see below), from making any deductions from interim payment certificates or otherwise without first notifying its claim under this Sub-Clause, thereby giving the Contractor the opportunity to respond to the Employer's claim prior to any deductions being made. The notification process is then followed by the mechanism provided in Sub-Clause 3.5 whereby the Engineer is required to agree or determine the matter following a consultation period. It is the amount determined by the Engineer that is then deducted from the interim payment certificate or claimed against the Contractor.

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<sup>5</sup> [2015] UKPC 37

In the event that there is a dispute between the Employer and the Contractor in relation to the Sub-Clause 3.5 determination, that dispute can then be referred to the DAB under Sub-Clause 20.4. So, for example, if the Engineer reduces the amount of the Employer's claim and the Employer is dissatisfied with the Engineer's assessment it can refer this dispute to the DAB. However, in most cases it will be the Contractor who will contest the decision of the Engineer.

The key elements in Sub-Clause 2.5 regarding the submission of an Employer's claim are: *"If the Employer considers himself to be entitled to any payment under any Clause of these Conditions or otherwise in connection with the Contract, and/or to any extension of the Defects Notification Period, the Employer or the Engineer shall give notice and particulars to the Contractor."* The clause continues that: *"The notice shall be given as soon as practicable after the Employer became aware of the event or circumstances giving rise to the claim"* and that *"The particulars shall specify the Clause or other basis of the claim, and shall include substantiation of the amount and/or extension to which the Employer considers himself to be entitled in connection with the Contract."*

The above provisions were considered in the case of *NH International (Caribbean) Ltd v National Insurance Property Development Company Ltd (Trinidad and Tobago)*<sup>6</sup>. In this case the arbitrator, first instance judge and Court of Appeal all took the view that Sub-Clause 2.5 could not prevent an employer raising a set-off to any claim by the Contractor. The arbitrator stated:

"I agree ....that clear words are required to exclude common law rights of set-off and/or abatement of legitimate cross-claims, and in my view such set off/abatement should be taken into account in the final reckoning following the termination. The terms of clause 2.5 do not prevent this. Also see Clause 11.10 as regards each party remaining liable for the fulfilment of any obligation remaining unperformed"

This approach followed an established line of authorities including ICC Case 11813 (2002),<sup>7</sup> in which a claim was made against an Employer for unpaid certified sums. The Employer raised as a defence a claim for liquidated damages and asserted that as a matter of English law it was entitled to raise a defence or set-off as it chose, except where such rights were expressly excluded. The Contractors argued that the Employer's rights to claim liquidated damages had been effectively excluded by the

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<sup>6</sup> [2015] UKPC 37;

[http://webopac.tlwcourts.org/LibraryJud/Judgments/HC/j\\_jones/2008/cv\\_08\\_04998DD21oct2009.pdf](http://webopac.tlwcourts.org/LibraryJud/Judgments/HC/j_jones/2008/cv_08_04998DD21oct2009.pdf)

<sup>7</sup> Reported in ICC International Court of Arbitration Bulletin Vol. 24 No. 2, Seppälä C. (2013) at page 49

provisions of Sub-Clause 2.5.<sup>8</sup> The arbitral tribunal found that although the Employer may be in breach of Sub-Clause 2.5, there was nothing within the contract that excluded the Employer's right to set-off.<sup>9</sup> In the circumstances, the arbitrator permitted the Employer to advance its set-off claim.

The Privy Council's opinion in *NH International (Caribbean) Ltd v National Insurance Property Development Company Ltd (Trinidad and Tobago)*<sup>10</sup>, took a different approach. Lord Neuberger stated:<sup>11</sup>

*"...it is hard to see how the words of clause 2.5 could be clearer. Its purpose is to ensure that claims which an employer wishes to raise, whether or not they are intended to be relied on as set-offs or cross-claims, should not be allowed unless they have been the subject of a notice, which must have been given 'as soon as practicable'. If the Employer could rely on claims which were first notified well after that, it is hard to see what the point of the first two parts of clause 2.5 was meant to be. Further, if an Employer's claim is allowed to be made late, there would not appear to be any method by which it could be determined, as the Engineer's function is linked to the particulars, which in turn must be contained in a notice, which in turn has to be served 'as soon as practicable'."*

The Privy Council then set out its reasoning why set-offs and counterclaims should be excluded and stated: "the purpose of the final part of the clause is to emphasise that, where the Employer has failed to raise a claim as required by the earlier part of the clause, the back door of set-off or cross-claims is as firmly shut to it as the front door of an originating claim." The Privy Council then proceeded to state that this did not, however, prevent an Employer raising a defence of abatement if the work had been done badly.<sup>12</sup>

The 2015 ICC Case, *ICC Case 16765*<sup>13</sup> followed the same approach of the Privy Council. The arbitral tribunal considered whether an Employer's counterclaim was admissible under a Yellow Book contract. The tribunal found that the Employer was

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<sup>8</sup> In this case the contract was FIDIC's Yellow Book (Test Edition, 1998). The clause, however, was similar to that used in the FIDIC 1999 Red Book.

<sup>9</sup> See *Gilbert Ash (Northern) Ltd v Modern Engineering (Bristol) Ltd* [1974] AC 689, which provides that under English law clear and express language is required to exclude a right of set-off. However, "any presumption that parties to a contract do not intend to give up their right to claim damages for breach of contract must likewise give way to the language of the contract" *Transocean Drilling UK Ltd v Providence Resources Plc* [2016] EWCA Civ 372 at para 21.

<sup>10</sup> [2015] UKPC 37;

[http://webopac.ttlawcourts.org/LibraryJud/Judgments/HC/j\\_jones/2008/cv\\_08\\_04998DD21oct2009.pdf](http://webopac.ttlawcourts.org/LibraryJud/Judgments/HC/j_jones/2008/cv_08_04998DD21oct2009.pdf)

<sup>11</sup> [2015] UKPC 37 at para 38

<sup>12</sup> *Ibid* at para 41; relying on the case of *Mellowes Archital Ltd v Bell Products Ltd* (1997) 58 Con LR 22, 25-30.

<sup>13</sup> ICC Dispute Resolution Bulletin 2015 No. 1, page 101

legally entitled to bring a claim to arbitration only if it first complied with Sub-Clauses 2.5, 3.5 and 20.4, paragraph 6. As the Employer had failed to comply with these “mandatory and exclusive provisions of the Contract regarding its claim for delay damages”, the Employer was contractually barred from bringing its counterclaim, which was declared inadmissible.

The English High Court recently considered Sub-Clause 2.5 in the case of *J Murphy & Sons Ltd v Becton Energy Ltd*.<sup>14</sup> This was a claim under FIDIC’s Yellow Book. In this case the question arose whether the Employer could claim liquidated damages despite not having gone through the Sub-Clause 2.5 and 3.5 procedures. The main difference in this case was that reference to Sub-Clause 2.5 in Sub-Clause 8.7 [delay damages] had been deleted and the court therefore had to construe the effect of the deletion on Sub-Clause 2.5.

The court held:

“In Sub-Clause 8.7 the words “*subject to Clause 2.5*” qualifying Murphy’s payment obligations do not appear, whereas in the equivalent standard clause in the FIDIC Yellow Book they do. Objectively assessed on the facts here, this selected deviation from the standard form is consistent with the parties’ intention being not to make Beckton’s right to claim delay damages subject in any way to Clauses 2.5 and 3.5. I accept that this is only context and certainly by no means determinative of the issue in Beckton’s favour. I also bear in mind the comments of Christopher Clarke J (as he then was) in *Mopani Copper Mines plc v Millennium Underwriting Limited* [2008] EWHC 1331 (Comm). To the extent that recourse to deleted words is permissible, care must be taken as to what inferences, if any, may properly be drawn. Here of course, the position is that the parties chose to agree a clause wholly different from the standard wording and one which excluded any reference to Sub-Clause 2.5. It is relevant background at least.”

On the facts Carr J held that the deletion of the reference to Sub-Clause 2.5 indicated that claims for delay damages did not need to go through the Sub-Clause 2.5 and 3.5 procedures. Her ladyship stated that:<sup>15</sup> “Sub-Clause 2.5 speaks of the amount agreed or determined by the Engineer as being included as a deduction in the Contract Price and Payment Certificates. Sub-Clause 8.7.4 on the other hand provides that delay damages due pursuant to Sub-Clause 8.7 shall be deducted from the next applicable Notified Sum.”

Employers may now want to amend the provisions of Sub-Clause 2.5 so that nothing within Sub-Clause 2.5 shall be construed as preventing any right of set-off or cross claim.

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<sup>14</sup> [2016] EWHC 607

<sup>15</sup> *Ibid* at para 50.

### Wrongful Deductions under Sub-Clause 2.5 and Termination

If the Employer does make deductions from the interim payments without having followed the process set out in Sub-Clause 2.5, the Contractor will be treated as not having been paid part of the amount due. This will be treated as non-payment of a sum due under an Interim Payment Certificate and will (if the non-payment is not remedied in time) give the Contractor the right to suspend, reduce the rate of working or terminate under Sub-Clauses 16.1 and 16.2. (see commentary on Sub-Clauses 16.1 and 16.2 and particularly Sub-Clause 16.2(c) where this consequence is expressly referred to). This, however, may not be the case under FIDIC's Silver Book which has a different payment regime: *Sedgman South Africa (Pty) Limited & Ors v Discovery Copper Botswana (Pty) Limited*.<sup>16</sup>

### Claims under Sub-Clause 2.5 Following Termination

An issue that has been considered in a number of text books is whether an Employer is bound by the provisions of Sub-Clause 2.5 following termination by the Employer under Clause 15. The problem has arisen because of the use of the word "may" at Sub-Clause 15.4.

Ellis Baker et al., *FIDIC Contracts: Law and Practice*, Section 8.222, p. 453, states the following:

"The word 'may' here is potentially confusing, because it could suggest that compliance with the requirement set out in Sub-Clause 2.5 (...) is optional (...). Furthermore, the Employer's rights to withhold further payment and to recover losses and damages from the Contractor under Sub-Clause 15.4 (b) and (c) respectively are not expressly stated to be subject to Sub-Clause 2.5 (...). In this way, there is a potential conflict between these provisions and those of Sub-Clause 2.5 (...), in particular in relation to the Employer's right of set-off (...). It is, however, suggested that, reading the Conditions as a whole, the most pragmatic interpretation of these provisions is that, on termination under Sub-Clause 15.2, the Employer's obligation to pay is generally suspended, but that his entitlement to claim any losses and damages is nevertheless still intended to be subject to Sub-Clause 2.5 (...). However, it would seem that the Employer does not have to submit particulars or substantiate the claim until the losses and damages incurred have been established."

The issue was considered by the ICC in Partial Award Case 15956.<sup>17</sup> The Arbitral Tribunal noted the apparent conflict between Sub-Clause 15.4 and Sub-Clause 2.5. However, in contradistinction to the view of Ellis Baker the tribunal held that "the

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<sup>16</sup> [2013] QSC 105

<sup>17</sup> ICC Dispute Resolution Bulletin 2015 No. 1 at page 44

apparent conflict between Sub-Clauses 2.5 and 15.4 cannot be resolved in favour of a precedence of Sub-Clause 2.5 by a mere exegetic construction.”

The approach adopted by the Arbitral Tribunal to the problem was one that was eminently sensible; looking not at the strict wording of the contract provisions but the intention behind those provisions. The Arbitral Tribunal referred to views expressed by Christopher Seppala and the "Seppala test”:

“A purpose of the pre-arbitral DAB procedure is for both Parties and, subsequently, any Arbitral Tribunal that may be constituted, to have the benefit of a decision of the DAB on any dispute. A decision of the DAB may increase the chance of a settlement and avoid the need to arbitrate the dispute. That purpose is subverted if a party is relieved from complying with Clause 20 in respect of a dispute merely because the other party has done so with respect to another dispute.

The test of whether, for example, a counterclaim raised by the employer must be submitted to the DAB for decision should be whether the contractor had previously requested the DAB to decide a dispute which necessarily would have resulted in a decision on that counterclaim.”

Mr Seppala then proceeds to give an example of an application of this test:

“An example of a dispute that the contractor might refer to a DAB which includes another dispute might be where the contractor claims that it has been wrongfully denied an extension of time by the engineer. Such a dispute might be considered to include the employer's claim (or potential claim) for liquidated damages (called "delay damages" in the FIDIC contracts) for the same time period. Therefore, the employer should not have to (although it may) submit such claim, as a dispute, to the DAB in order to be able to assert it as a counterclaim in the arbitration.”

Mr Seppala's test accords with the common law approach to set-off in adjudication cases as stated by Jackson J in *Balfour Beatty Construction v Serco Ltd.*<sup>18</sup>

In Partial Award Case 15956<sup>19</sup> the Arbitral Tribunal held that the DAB's First Decision did include the DAB's opinion as to the issues of extension of time for completion of the Works and as to the termination of the Contract by Claimant. Applying the Seppala test the Arbitral Tribunal concluded that he was entitled to deal with the Employer's claim for delay damages despite the fact that it had not gone through the Sub-Clause 2.5 procedure.

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<sup>18</sup> [2004] EWHC 3336

<sup>19</sup> ICC Dispute Resolution Bulletin 2015 No. 1 at page 44



## Exceptions

Sub-Clause 2.5 states: “However, notice is not required for payments due under Sub-Clause 4.19 [*Electricity, Water and Gas*], under Sub-Clause 4.20 [*Employer’s Equipment and Free-Issue Material*], or for other services requested by the Contractor.” Accordingly there is no time limit in which the Employer must notify the Contractor of its intention to claim in relation to these two sub-clauses. Both Sub-Clauses 4.19 and 4.20 refer to the Engineer’s involvement of agreeing or determining in accordance with Sub-Clause 2.5 and Sub-Clause 3.5.

It is submitted that the only way of making sense of these rather awkwardly worded clauses is that in relation to Sub-Clauses 4.19 and 4.20, the first two paragraphs of Sub-Clause 2.5 do not apply but that the last two paragraphs of Sub-Clause 2.5 do apply. The Employer will thus still need to give particulars setting out the basis of the claim and substantiation of amount and following receipt of the particulars the Engineer will be obliged to go on to agree or determine the sums due under Sub-Clause 3.5.

A claim for an abatement is a further exception to the rule that Employer’s claims need to go through the Sub-Clause 2.5 and 3.5 procedure.<sup>20</sup> An abatement can occur where “the work for which the contractor is seeking a payment was so poorly carried out that it does not justify any payment, or that it was defectively carried out so that it is worth significantly less than the contractor is claiming.”

In 2006 in *Cleveland Bridge v Multiplex*<sup>21</sup> Mr Justice Jackson set out a summary of the legal principles relating to abatement. The principles were as follows:

- in a contract for labour and materials where performance has been defective the employer is entitled to maintain a defence of abatement;
- the measure of the abatement is the amount by which the product of the contractor's endeavours has been diminished in value as a result of the defective performance;
- depending on the facts, this difference may be determined by comparing the market value of what has been constructed with what ought to have been built, or by reference to the cost of remedial works (but not the cost of the remedial works themselves);
- the measure of abatement can never exceed the sum which would otherwise be due to the contractor as payment;
- abatement is not available as a defence to a claim in respect of professional services;<sup>22</sup>

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<sup>20</sup> *NH International (Caribbean) Ltd v National Insurance Property Development Company Ltd (Trinidad and Tobago)* [2015] UKPC 37 at para 41

<sup>21</sup> [2006] EWHC 1341

- claims for delay, disruption or damage caused to anything other than that which the contractor has constructed cannot feature in a defence of abatement.

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<sup>22</sup> See *William Clark Partnership Ltd v Dock St PCT Ltd* [2015] EWHC 2923 where the court held “I am satisfied that it is open to Dock Street as a matter of law to defend itself in relation to a claim for payment for services rendered by a professional by contending that all, or some specific part, of those services were either not performed at all or were performed so poorly that they were worthless. Insofar as the complaint only applies to a specific part of the contracted-for services, Dock Street may defend itself by reference to the value of that specific part. What Dock Street may not do, however, is to defend itself by contending that all, or some specific part, of the services were performed, but not fully or properly in every material respect, so as to seek a reduction of the price payable in relation to the whole or the specific part..”