Employers Beware

Written by Victoria Tyson

How important is it for an Employer to give a Sub-Clause 2.5 notice of a set-off or cross-claim under the FIDIC Red Book form of contract? Very, according to the Privy Council in NH International (Caribbean) Limited v National Insurance Property Development Company Limited[1]. It found that:

- **Sub-Clause 2.5 applies to any claims the Employer wishes to make.**
- **The Employer must make such claims promptly and in a particularised form.**
- **Where the Employer fails to raise a claim as required, the back door of set-off or cross-claims is firmly shut.**

The case also serves as a warning to Employers who take a relaxed view towards their obligation under Sub-Clause 2.4 to provide reasonable evidence of the financial arrangements they have made and are maintaining to pay the Contract Price. It doesn't matter how wealthy or important the Employer is (it may be a Government, company or individual with very substantial funds) detailed financial information must still be provided.

The key facts

- The case concerned two appeals from the Court of Appeal of the Republic of Trinidad and Tobago.
- On 6 March 2003 a contract based on the FIDIC Red Book for the construction of a hospital in Tobago had been entered into by National Insurance Property Development Company Limited (the "Employer") and NH International (Caribbean) Limited (the "Contractor") for an original Contract Price of TT$118 million.
- The works commenced in March 2003 with an original completion date of March 2005.
- The Contractor first suspended work in September 2005 and then terminated the contract in November 2006.
- The disputes were referred to arbitration.
- Dr Robert Gaitskell QC was appointed as sole arbitrator in October 2005 and made five awards.
- Two issues were challenged (i) the Contractor's entitlement to terminate (which was decided in his second award), and (ii) quantum (which was decided in his third award).

The Contractor's entitlement to terminate

Sub-Clause 2.4 states:

"The Employer shall submit within 28 days after receiving any request from the Contractor, 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 [Contract Price and Payment]….".

As the works were executed the cost of the project was rising and so in September 2004 the Contractor quite sensibly requested that the Employer provide evidence of its financial arrangement under Sub-Clause 2.4 of the contract, and this further evidence was provided in December 2004. A further request was made by the Contractor in April 2005 and this was provided in July 2005 but on a rather unusual "without prejudice" basis. The Contractor understandably queried the "without prejudice" nature of the response and asked whether the Employer had obtained Cabinet approval for payment of the sums under the contract (as other contracts showed that Cabinet approval was needed, for public policy reasons, before money could be paid). No response was received and so the Contractor suspended work in September 2005.

Tel: + 44 (0)20 8614 6200
Fax: + 44 (0)20 8614 6222
Email: info@corbett.co.uk
www.corbett.co.uk

In October 2006 (over a year later) the Employer wrote stating that it would meet the contractual financial requirements for completion of the project. The Contractor patiently requested confirmation that the Cabinet had approved the funds but again no response was received. So, in November 2006 the Contractor terminated the contract for a failure by the Employer to provide reasonable evidence that financial arrangements had been made and maintained. The Employer disputed the termination.

In April 2007, the arbitrator found that the Contractor had been entitled to terminate as there was no *"reasonable evidence that financial arrangements had been made and maintained"* to pay the sums referred to in the documentation provided. Of Sub-Clause 2.4 the arbitrator wrote in his second award:

"The mere fact than an Employer is wealthy is inadequate for the purpose of Sub-Clause 2.4. Similarly, the mere fact than an Employer has good reasons for wanting a project completed does not itself mean he has made and maintained the necessary financial arrangements. Accordingly, the evidence given at the hearing to the effect that the [Employer] has very substantial funds is, prima facie, insufficient by itself for satisfying 2.4. Does the mere fact that the [Employer] has funds in general mean it has "made arrangements" enabling it to pay? The answer emerging from the evidence … as regards the significance of cabinet approval, is that (quite property, and for very good public policy reasons) the [Employer] cannot pay large sums of public money in respect of cost overruns on construction contracts unless cabinet approval is given in advance or, perhaps, retrospectively. The issue of cabinet approval cannot simply be ignored. It is, at some point, an essential element of any "arrangement" to pay.

What was required was evidence of *"positive steps"* on the part of the Employer which show that financial arrangements had been made to pay sums due under the contract.

The High Court[2] agreed but the Court of Appeal[3] did not on the basis that the arbitrator had been demanding the *"highest assurance"* of evidence rather than mere *"reasonable evidence"* and accused the arbitrator of giving too little weight to certain evidence.

However, the Privy Council found that the arbitrator had made no error in law. The arbitrator's conclusion that insufficient evidence had been provided was one of fact not law, and therefore it was not open to a court to interfere with, or set aside, his conclusions on such an issue. It stated:

"Where parties choose to resolve their disputes through the medium of arbitration, it has long been well established that the courts should respect their choice and properly recognise that the arbitrator's findings of fact, assessments of evidence and formations of judgment should be respected, unless they can be shown to be unsupportable. In particular, the mere fact that a judge takes a different view, even one that is strongly held, from the arbitrator on such an issue is simply no basis for setting aside or varying the award. Of course, different considerations apply when it comes to issues of law, where courts are often more ready, in some jurisdictions much more ready, to step in."

The Contractor's termination for the Employer's breach of Sub-Clause 2.4 was therefore upheld.

As an aside, the obligation under Sub-Clause 2.4 relates to the Contract Price which is defined as *"the price defined in Sub-Clause 14.1 [the Contract Price], and includes adjustments in accordance with the Contract"*. Often the Employer and Contractor will have differing views on the amount of the Contract Price, as is apparent in this case where the Contractor requested evidence of the ability to pay TT$286 million, and the Employer wrote back with reference to its estimate of TT$224 million. The Privy Council agreed with the Court of Appeal who ruled that TT$224 million was the correct sum as this had been certified by the Engineer and ultimately verified by an Independent Quantity Surveyor.

Tel: + 44 (0)20 8614 6200
Fax: + 44 (0)20 8614 6222
Email: info@corbett.co.uk
www.corbett.co.uk

Financial claims

Whilst the matter of the termination was being appealed the arbitrator heard submissions on quantum and issued his third award.

The Contractor claimed its financial losses arising out of the termination; in response the Employer submitted various counterclaims. The Contractor argued that the Employer's counterclaims were barred for a lack of notice under Sub-Clause 2.5. In fact, the first the Contractor had heard of the counterclaims was during the arbitration proceedings!

Sub-Clause 2.5 states:

"If the Employer considers itself to be entitled to any payment under any Clause of these Conditions or otherwise in connection with the Contract … the Employer or Engineer shall give notice and particulars to the Contractor…

The notice shall be given as soon as practicable after the Employer became aware of the event or circumstances giving rise to the claim …

The particulars shall specify the Clause or other basis of the claim, and shall include substantiation of the amount … to which the Employer considers himself to be entitled. The Engineer shall then proceed in accordance with Sub-Clause 3.5 [Determinations] to agree or determine (i) the amount (if any) which the Employer is entitled to be paid by the Contractor …

This amount may be included as a deduction in the Contract Price and Payment Certificates. The Employer shall only be entitled to set off against or make any deduction from an amount certified in a Payment Certificate, or to otherwise claim against the Contractor, in accordance with this sub-clause"."

In November 2008 the arbitrator found that notice was not required for the Employer's counterclaims because *"clear words are required to exclude common law rights of set-off and/or abatement of legitimate cross-claims"* and (by implication) the words of Sub-Clause 2.5 were not clear enough. The High Court[4] and the Court of Appeal[5] agreed with the arbitrator.

The Privy Council took a different view. It found the words of Sub-Clause 2.5 couldn't be clearer.

- Sub-Clause 2.5 applies to any claims the Employer wishes to make (whether or not they are intended to be relied on as set-offs or cross-claims).
- The Employer must make such claims "as soon as practicable" and in a particularised form. If the Employer can rely on claims which were first notified well after that, there would be no point to the first two parts of Sub-Clause 2.5. Further, if the Employer's claim is allowed to be made late, there is no 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".
- Where the Employer fails to raise a claim as required, the back door of set-off or cross-claims is firmly shut in accordance with the final words of the Sub-Clause which read "The Employer shall only be entitled to set off against or make any deduction from an amount certified in a Payment Certificate, or to otherwise claim against the Contractor, in accordance with this sub-clause".

However, with reference to Hobhouse LJ in *Mellowes Archital Ltd v Bell Products Ltd.*[6] the Privy Council did concede that Sub-Clause 2.5 does not preclude the Employer from raising an abatement – e.g. that 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.

The third award was therefore remitted to the arbitrator with a recommendation that any sums which (i) were not the subject of appropriate notification complying with the first two parts of Sub-Clause 2.5 and (ii) cannot be characterised as abatement claims as opposed to set-offs or cross-claims, must be disallowed.

Tel: + 44 (0)20 8614 6200
Fax: + 44 (0)20 8614 6222
Email: info@corbett.co.uk
www.corbett.co.uk

Conclusion

In summary, there is no excuse for poor contact administration. Employers should ensure that notices are given on time and, when asked to do so, provide evidence that financial arrangements to pay the Contract Price have actually been made and are being maintained. If there is in any doubt about the Contract Price ask the Engineer to certify the sum and if necessary seek an independent opinion.

[1] [2015] UKPC 37

[2] Claim No. CV2007-02224

[3] C.A. No. 281 of 2008

[4] Claim No. CV2008-04998

[5] Civil Appeal No. 246 of 2009

[6] [1997] 58 Con LR 22, 25-30

Article Author

Victoria Tyson

Email: victoria.tyson@corbett.co.uk

Tel: + 44 (0)20 8614 6200
Fax: + 44 (0)20 8614 6222
Email: info@corbett.co.uk
www.corbett.co.uk