REGIONAL

Contractors' Claims Under The FIDIC International Civil Engineering Contract—I

by Christopher R. Seppala, Esq.

This is the first in a series of articles in which Christopher Seppala discusses contractors' claims under the FIDIC International Civil Engineering Contract and the steps contractors can take to secure and advance their rights. The discussion is organized in six sections: Section I—An Overview (introduction); Section II—The Role of the Engineer; Section III—The Contractor's Major Claims (covering (A) Unforeseen Conditions and Obstructions, (B) Variations, and (C) Delays); Section IV—Other Claims; Section V—Claim Notification Procedure and Disputes; Section VI—Conclusion. This first article covers through Section II.

The FIDIC international civil engineering contract[1] (the FIDIC Conditions) has enjoyed wide currency in recent years due, in part, to the boom in international construction in the oil-producing countries. According to one source, the FIDIC Conditions "govern close to 30 percent of the civil engineering contracts in the Middle East and most of the projects financed by the World Bank."[2] The FIDIC Conditions probably remain the most widely-used standard form of contract conditions in international construction, although those letting out construction projects (Employers[3]) frequently modify the terms in practice.[4]

I. The FIDIC Conditions: An Overview

Though described as international, the FIDIC Conditions derive from, and remain closely modeled on, a form of conditions of contract used for civil engineering work in England—the Conditions of Contract of the English Institution of Civil Engineers (the ICE Conditions).[5] Thus, the FIDIC Conditions incorporate, among other things, the traditional English contract system under which important administrative and quasi-judicial powers are conferred on the person supervising execution of the works on the Employer's behalf—the engineer (Engineer[6]).

While this system was exported in the nineteenth century to countries of the former British empire (Canada, Australia, South Africa, etc.) and adopted in the United States, it remains fundamentally different from construction contract practices on the continent of Europe and elsewhere, where the contract supervisor's powers are

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IRAN

Beware Of Middlemen Bearing Phony Claims Of Influence

by a special correspondent

In doing business in Iran, the dangers of falling for middlemen's phony claims of influence are illustrated by the recent United States/Iran arms deal fiasco. The assurances of middlemen that a warm reception awaited President Reagan's negotiators in Tehran—". . . and why don't you take a few presents; they will go down well"—proved horribly hollow when put to the test. Anticipated cozy talks in Iran's presidential offices turned into uneasy interrogation sessions under detention in a Tehran hotel.

The lesson for business people: when intermediaries anxious to earn introduction fees and sales commissions claim to have a direct line to one of the highest officials in the land, beware.

Wheeler-Dealing Middlemen

Many Western companies still believe that when dealing with Iran, it is "who you know rather than what you know" that counts. Before the revolution, that was often true. Where large contracts were involved, wining and dining of important government officials opened doors for many companies. More progress was achieved on the marbled terraces of Shemran residences and palaces than in ministry offices.

"When a middleman claims influence with the procurement officer of a large state-owned company, there is no way of checking the name or title in a reference book . . . .The good middleman . . . proves himself by results and not by the number of names he can reel off."

Today, the situation is different. Top officials are far less accessible socially than their prerevolutionary counterparts and rarely accept invitations from Westerners. There is no longer the possibility of establishing contact with a minister at a smart cocktail party and following this up through the dinner party circuit. True, a certain amount of business is cemented in chic restaurants and hotel lobbies throughout Europe, but in most cases the contacts are well established first. Discussions with Iranian exiles who frequent international hotels in the hope of being taken on as intermediaries (known in international circles as hotel lounge lizards) only occasionally result in actual business.

For companies that are not established but want to get into the market, the main problem in dealing with these intermediaries is that not "who you know" but "do they really know the people they claim to know" becomes crucial. If every Iranian who claimed to know Majles Speaker Hashemi Rafsanjani, to personally represent Ayatollah Hosein Ali Montazeri, or to have a direct line to this or that

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more attenuated and the Employer's authority is commensurately greater.

Rights

Like the English contract conditions from which they derive, the FIDIC Conditions confer important claim rights on the Contractor. More than 30 different clauses provide that the Contractor may, in specified circumstances, be entitled to claim additional money or an extension of time for completion of the works, or both, from the Employer if conditions change or differ from those existing or foreseen at the date of contract.[7]

The FIDIC Conditions also provide numerous instances where the Employer may assert claims against the Contractor. The Employer's position, however, is fundamentally different from that of the Contractor. As the contract paymaster, the Employer is usually in a position to satisfy his claims by set-offs against, or reductions in, the amounts due or to become due to the Contractor.[8]

The Contractor, on the other hand, has no alternative if he is to be paid but to observe the claims procedures laid down in the contract. Therefore, if the Contractor is to recover the amounts due him, he must be familiar with:

- the contractual circumstances under which he may assert a claim, and
- the contractual procedures to be observed for getting the claim paid.

Claims

A Contractor may assert two basic types of claims against the Employer.

- He may claim additional compensation or an extension of time by virtue of a clause in the FIDIC Conditions.
- Alternatively, he may claim additional compensation based upon a provision of the applicable municipal law—*e.g.*, a claim relating to a breach of contract for which the contract terms provide no remedy or a claim relating to a tort such as fraud or negligence.

This series of articles addresses only the first type of claim, that is, one based on a clause of the FIDIC Conditions. It does not discuss the second type of claim, based purely in law, the nature and availability of which may vary with the municipal law applicable.

As a general rule, during the performance of the works, it will be in the Contractor's interest to claim under a clause (or clauses) of the FIDIC Conditions whenever this is feasible. A valid claim based on a particular clause is more likely to be entitled to interim payment[9] and is, as well, readily susceptible of evaluation by the Engineer. On the other hand, a claim based purely in law, and not on the FIDIC Conditions, may not be entitled to interim payment. In addition, such a claim arguably (if FIDIC's own position is accepted) may be beyond the Engineer's power to settle. FIDIC states that:

> The Engineer's task is to interpret the Contract as written and not to determine the legal rights of either party[10]

which suggests that, as a claim based in law could not be settled by the Engineer, it might only be settled by, and in the event of, an international arbitration in relation to the contract concerned.[11]

Three Major Claim Areas

Three of the major claim areas under the FIDIC Conditions are:

- unforeseen conditions and obstructions (Clause 12);
- variations or changes in the works (Clauses 51 and 52); and
- delays (Clause 44 and others).

This series of articles will concentrate primarily on these three types of claims (Section III). Brief reference will be made to the other types of claims available to the Contractor under the FIDIC Conditions (Section IV), to the procedure for the notification of claims (Clause 52(5)) and to the settlement of disputes (Clause 67) (Section V).

Before considering the major claim areas, however, it is necessary to discuss the special role of the Engineer under the FIDIC Conditions.

II. Role Of The Engineer

When an Employer plans the execution of a civil engineering project to be let out for international competitive bidding, he will ordinarily wish to appoint a consulting engineer to advise him and to act on his behalf. The Employer ordinarily then will enter into an agreement with such engineer (herein the Engineer) pursuant to which the Engineer will agree, among other things, to prepare initial studies and a feasibility report and, assuming the Employer decides to proceed with the project, the tender and contract documents and drawings. Often, the Engineer will further agree that, once the construction contract is signed, he will supervise the execution of the works by the Contractor.[12]

Powers And Duties

Although the Employer's agreement with the Engineer will refer generally to the construction contract to be entered into between the Employer and the Contractor, the Engineer will not be a party to the construction contract. However, when the FIDIC Conditions are incorporated into the construction contract that is signed, the effect of their terms is to confer a distinct function on the Engineer: he becomes the administrator of the contract and, for this purpose, is accorded important powers and duties that extend beyond his agency relationship with the Employer.

The powers and duties that the FIDIC Conditions confer include, among others, the following:

- to certify the value of work for purposes of interim and final payment to the Contractor;[13]
- to order "variations" in the works[14] or "suspensions" in the execution of the works;[15]
- to decide the Contractor's claims for additional monies or for extensions of time;[16] and
- to decide disputes or differences, if any, between the Contractor and the Employer or the Engineer, subject,

however, to the right of the Employer or the Contractor, if dissatisfied with the Engineer's decision, to refer the matter to international arbitration.[17]

Dual Role

In performing these various administrative duties, the Engineer is regarded as having a dual role.

On the one hand, he is considered as acting as the agent of the Employer in supervising construction and in ensuring that the Contractor executes the works properly in accordance with the terms of the construction contract.

On the other hand, in performing certain other administrative functions and, in particular, in deciding on the Contractor's claims for additional payment or extensions of time and in settling disputes under the contract, the Engineer is not expected to act only in the Employer's interest. Instead, he is regarded as having an implied duty[18] to act with complete independence—that is, to apply the contract "impartially, honestly and with professional integrity towards both parties to the contract."[19]

Required Independence

While the Engineer, in considering the Contractor's claims, is entitled to receive representations from either party, he is not entitled to accept instructions as to the position he should adopt. If the Employer gives such instructions, he may be in breach of the contract;[20] if the Engineer accepts them, he would, at least under English law, be guilty of "misconduct" (as would an arbitrator who failed to act impartially). Even if a Contractor's claim or a dispute calls into question the conduct of the Employer or of the Engineer himself (*e.g.*, an alleged error in the Engineer's design), the Engineer is required, under English law at least, to decide it independently and without bias.[21]

Many question whether it is realistic to expect a person in the Engineer's position to perform his administrative functions with the required independence, especially when a claim may put in dispute the Engineer's own conduct or that of the Employer who has hired, pays, and may replace him.[22] Nevertheless, there can be no doubt that the efficient functioning of the procedures for the settlement of the Contractor's claims under the FIDIC Conditions hinges largely on the faithful fulfillment of the Engineer's impartial role. As one engineer has written:

> The efficiency of the system written into the FIDIC Contract for settling all claims and solving all disputes relies heavily on the one hand upon strict compliance by the Contractor with the proper drill for making claims combined with, on the other hand, *strict compliance by the Engineer, in an impartial way, with the proper drill for settling claims.* (Emphasis added)[23]

As all claims of the Contractor must be submitted to the Engineer (and as all communications from the Employer to the Contractor are expected to pass through the Engineer[24]), the Engineer is, for most practical purposes, the highest adjudicator of rights and claims under the contract.

The ultimate recourse against a decision made by the Engineer is international arbitration.[25] Under the current edition of the FIDIC Conditions, the Contractor can commence arbitration before completion of the works.[26] Normally he will in practice refrain from doing so, however, in order to avoid jeopardizing his relations with the Employer (while the Employer is still making regular, if insufficient, payments) and placing his bonds[27] and retention monies, if any,[28] at risk. Moreover, if the Contractor has one claim he wishes to arbitrate, he will usually have others, and if he has others, he will ordinarily prefer to assert them all together in a single proceeding, after approval by the Engineer of the Contractor's final account.[29] Consequently, arbitration will usually only be commenced, in practice, after the works have been completed.

For these reasons, among others, when a project is let out on the basis of the FIDIC Conditions, the identity of the person chosen to act as the Engineer is critical to:

- an evaluation of the risks of the project by the Contractor, and
- in particular, the likelihood or not that his claims will be evaluated fairly and settled promptly.

Footnotes

[1]The exact title is CONDITIONS OF CONTRACT (INTERNATIONAL) FOR WORKS OF CIVIL ENGINEERING CONSTRUCTION WITH FORMS OF TENDER AND AGREEMENT (3rd ed. March 1977). Several organizations have approved this document, including the *Fédération Internationale des Ingénieurs-Conseils* (FIDIC) and various organizations of contractors. The commentaries on the FIDIC Conditions include FIDIC, NOTES ON DOCUMENTS FOR CIVIL ENGINEERING CONTRACTS (FIDIC, Lausanne 1977) (FIDIC NOTES) and the following unofficial commentaries:

- I.N. DUNCAN WALLACE, THE INTERNATIONAL CIVIL ENGINEERING CONTRACT (Sweet & Maxwell, London 1974 and Supp. 1980) (DUNCAN WALLACE).
- GLYN P. JONES, A NEW APPROACH TO THE INTERNATIONAL CIVIL ENGINEERING CONTRACT (The Construction Press Ltd., Lancaster 1979) (JONES).
- JOHN C. SAWYER and C. ARTHUR GILLOT, THE FIDIC CONDITIONS. DIGEST OF CONTRACTUAL RELATIONSHIPS AND RESPONSIBILITIES (Thomas Telford Ltd., London 2nd ed. 1985).

[2]ANDRE BRABANT, LE CONTRAT INTERNATIONAL DE CONSTRUCTION 164 (Brussels 1981) (translation from French).

[3]Also called Employers in the FIDIC Conditions.

[4]For example, the standard *General Conditions for Contracts of Civil Engineering Works* of the Republic of Iraq, Ministry of Planning, Legal Department, which has been widely used by Iraqi state entities, is derived, with numerous modifications, from the FIDIC Conditions, second edition.

[5]The current edition of the FIDIC Conditions, namely the third edition dated March 1977, is based closely on the fourth (1955) and fifth (1973) editions of the ICE Conditions. Commentaries on the ICE Conditions are therefore instructive in the interpretation of the FIDIC Conditions. The current edition of the FIDIC Conditions is in the course of revision, and it is anticipated that a new, fourth, edition will be issued soon, possibly this year.

[6]Also called the Engineer in the FIDIC Conditions. The role of the Engineer is discussed later in this article.

[7]It is unfortunate that commentaries on individual clauses in the FIDIC NOTES, while useful, are too succinct to be of great assistance. Moreover, these commentaries are preceded by the following statement:

> "The Notes which follow . . . must not be taken as representing in any way an interpretation of the text of these Clauses." (FIDIC NOTES, *supra* note 1, at 17)

which raises the question of what weight can be given to them, if any. While the FIDIC NOTES were drawn up by FIDIC, they, unlike the FIDIC Conditions, have apparently not been approved by any organizations of contractors.

[8]For a list of the Employer's claims under the FIDIC Conditions, see JONES, *supra* note 1, at 192-93.

[9]*See* Clause 52(5). Compare the payments provision, Clause 60, of the English ICE Conditions (fifth edition) which, as regards claims, contemplates payments of amounts "for which provision is made under the contract" only (Clause 60(1)(d)). The comparable provision in the FIDIC Conditions is less explicit. *See* the notes on Clause 60 in part II of the FIDIC Conditions.

[10]FIDIC NOTES, *supra* note 1, at 16.

[11]*See* Clause 67. The wording of Clause 67 is broad enough to encompass the settlement thereunder of a claim based in law whether by the Engineer or by arbitrators. In the author's view, FIDIC takes too narrow

a view of the Engineer's role. The Engineer should be entitled to seek legal advice and, on the basis of such advice, settle claims based in law. If it is considered desirable that, to the extent possible, all claims in relation to the contract concerned be settled at the level of the Engineer instead of by international arbitration, then surely it is consistent with that objective that he should also be empowered, after taking legal advice, to settle claims in law.

[12]*See* FIDIC, INTERNATIONAL MODEL FORM OF AGREEMENT BETWEEN CLIENT AND CONSULTING ENGINEER AND INTERNATIONAL GENERAL RULES OF AGREEMENT BETWEEN CLIENT AND CONSULTING ENGINEER FOR DESIGN AND SUPERVISION OF CONSTRUCTION OF WORKS (FIDIC, Lausanne 3rd ed. 1979) (I.G.R.A. Contract).

[13]Clause 60.

[14]Clause 51.

[15]Clause 40.

[16]The relevant clauses are referred to in Sections III (The Contractor's Major Claims) and IV (Other Claims) of this series of articles.

[17]Clause 67.

[18]This refers to the common law doctrine of "implied terms" which has been imported into this "international" contract. For a discussion (in French) of this doctrine in relation to the FIDIC Conditions by a lawyer from a civil law country, see BRABANT, *supra* note 2, at 157-59.

[19]ICE Conditions of Contract Standing Joint Committee, *Guidance Note 2A: Functions of the Engineer under the ICE Conditions of Contract* (1977) (GUIDANCE NOTE 2A). While this note was issued in relation to the English ICE Conditions, the same principle may be regarded as applicable to the FIDIC Conditions. The FIDIC NOTES themselves state that: "... so far as his duties are discretionary [*i.e.*, not limited by his role as agent], the Engineer will act fairly between Employer and Contractor and interpret the contract in a completely unbiased manner." FIDIC NOTES, *supra* note 1, at 7.

[20]GUIDANCE NOTE 2A, *supra* note 19.

[21]The fact that the Engineer may be no more than an employee of the government or public authority which is acting as the Employer under the Contract (as is often the case today internationally, *e.g.*, in Iraq or Nigeria) does not, under English law, change this principle. "Just as the contractor has accepted the engineer as a 'judge' so must the local authority who employ[s] him and he must not allow himself to be influenced by the fact that he is also the servant of the authority." (J. B. WIKELEY, MUNICIPAL ENGINEERING LAW AND ADMINISTRATION 29 (C.R. Books Ltd., London 1964)). FIDIC adopts the same point of view. *See* FIDIC NOTES, *supra* note 1, at 7. However, the Subcommittee on the FIDIC Conditions of Committee T (International Construction Contracts) of the Section on Business Law, International Bar Association, among others, has criticized the use of a member of the Employer's own staff as the Engineer. *See* 11 INT'L BUS. LAW. 211 (1983).

[22]Clause 1(c). It has been stated to be a "somewhat naive fiction" to believe that, irrespective of the matter placed before the Engineer, he will act in an objective, fair and unbiased manner. *See* Myers, *Finality of Decisions of Design Professionals Where the Contract Provides the Decisions Will Be Final*, 2 I.C.L.R. 319, 327 (1985).

[23]JONES, *supra* note 1, at 183.

[24]FIDIC NOTES, *supra* note 1, at 15.

[25]Clause 67.

[26]The previous edition of the FIDIC Conditions, the second edition, had prohibited arbitration before completion, with certain exceptions. *See* Clause 67 of such edition.

[27]Assuming, as will usually be the case in practice, that the bonds are of the "first demand" type. *See* Clause 10.

[28]*See* Clause 60 in Part II of the FIDIC Conditions.

[29]Clause 60 in Part II of the FIDIC Conditions contemplates that, after the issue of the Maintenance Certificate, the Contractor submit a statement of final account to the Engineer for his verification in order to determine the final amount which in the Engineer's opinion is finally due under the contract and the balance, if any, due from the Employer to the Contractor, or *vice versa*. The final account will ordinarily reflect the Engineer's final view on the Contractor's claims.

SAUDI ARABIA

New Budget Announced

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years, expenditures have gradually decreased until a bottom was reached at the beginning of 1986, according to one banker, who predicted that the bottoming out would last around three years, perhaps through 1988.

Deficit Steady

The announced budget, with its deficit of SR 52 billion, indicates that the deficit will remain steady at around SR 50 billion for two more years, said the same banker, with the government drawing down reserves for two more years and counting on the oil price to firm by the end of the decade. In 1984-85, the deficit was SR 44 billion; in 1985-86 it grew to SR 50 billion; and during the last shorter 10-month period, it held steady at about SR 40 billion for the whole period, according to estimates.

Bankers and diplomats also note that the announced budget was very conservative on the revenue side, with the government seemingly underestimating the price it would get for its oil.

Drawdowns

In order to meet commitments and guarantee political stability, the government had to come up with a budget of at least SR 150 billion to SR 200 billion, said one observer. Rather than take any risks, the authorities chose to use reserves to buy political stability. An alternative, a devaluation of the riyal, would have had to be so dramatic to be effective that it was not a practical solution to this problem. One banker estimated that the riyal would have to go over six to the dollar before the spending gap could be bridged.

The drawdown on reserves may reflect the Saudis' satisfaction with their investments abroad. The Saudis, with the highest reserves in the world, reportedly have substantially increased their reserves over the last year or so through some clever investing. Nevertheless, it will be a difficult task for the Saudi Arabian Monetary Agency (SAMA) money managers to decide which assets to sell off, since many of the short-term investments have already been liquidated, according to bankers. (See page 24 of this issue for an article on the Saudi reserves.)

Project Allocation

In announcing the budget, the government said there would be SR 50 billion set aside for projects. One analyst estimated, however, that necessary current expenditures such as operations and maintenance and salaries would take up to about SR 120 billion of the total SR 170-billion budget, with an additional SR 3.5 billion needed for credit institutions and around SR 10 billion for foreign aid. That would leave, he said, under SR 40 billion for projects, a figure rather better than the previous year's.

The question in the minds of bankers, business people, and diplomats is whether this discretionary SR 40 billion will be used to start up new projects or to pay for old ones.

Over the past three years, the movement of funds down the government pipeline had progressively slowed, with the private sector effectively being asked to finance a government deficit interest free. The effects have spread from