Tunnel Vision: The English High Court Considers The FIDIC Yellow Book

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The English Court considers termination and notice provisions under the FIDIC Yellow Book 1999.

- **How are clause 15.1 notices to correct limited?**
- **Do termination events have to be repudiations?**
- **Is it fatal to serve notice of termination on the 'wrong' address?**
- **When does the 28-day period under clause 20.1 start to run?**

Mr Justice Akenhead offers guidance to the industry.

Introduction

Reported FIDIC cases are rare as disputes under these forms of contract are normally resolved in private Dispute Adjudication Board or confidential arbitration proceedings. Consequently, they are often of considerable precedential value either formally or informally. One recent case is *Obrascon Huarte Lain SA -v- Her Majesty's Attorney General for Gibraltar [2014]* EWHC 1028 (TCC) which was transferred from the Gibraltar Courts to the specialist expertise of the Technology and Construction Court of England and Wales by agreement of the parties.

The case concerned a dispute arising out of a £30 million contract for design and construction work to Gibraltar Airport. The contract incorporated the FIDIC Conditions of Contract for Plant and Design Build for Electrical and Mechanical Plant, and for Building and Engineering Works, designed by the Contractor, First Edition 1999, commonly known as the Yellow Book.

Currently, the road to the Spanish border traverses the airport runway so that it must be closed when the runway is in use. With a view to relieving the congestion caused by its frequent closure, the works included the construction of a new dual carriageway and tunnel under the eastern end of the airport runway.

The contract was entered into in November 2008 and works commenced the following month. After over 2½ years and with only 25% of the work done the contract was terminated by the employer, the Government of Gibraltar. The Spanish contractor Obrascon Huarte Lain ('OHL') commenced proceedings for extension of time and costs.

Although Gibraltar is famous for its rock and despite the airport site's historic military use, the contractor argued that it had encountered more rock and contaminated material than would have been reasonably foreseeable by an experienced contractor at the time of tender. The contractor also argued that a report it had commissioned, which concluded that airborne contamination posed a health and safety risk, meant that it was necessary to suspend the excavation works and re-design the tunnel.

The Court disagreed with the contractor's arguments and found *inter alia* that the contractor had failed to proceed with the design and execution of the works with due expedition and without delay. The contractor was awarded just 1-day extension of time from the 660 days originally claimed. The Court was especially critical of the report heavily relied upon by the contractor to support its suspension of the works and redesign of the tunnel, which it described *as 'palpably and obviously inept, was clearly worked on by OHL and cannot have been considered by OHL to be independent or competent'*[1].

The Court found that the contractor was responsible for the termination and that the employer had lawfully terminated the contract. The Court was not asked to consider quantum which was left for a later date.

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How are clause 15.1 notices to correct limited?

In determining who was responsible for the termination, the Court first reviewed clause 15.1 the contract, which states:

> *"15.1 If the Contractor fails to carry out any obligation under the Contract, the Engineer may by notice require the Contractor to make good the failure and to remedy it within a specified reasonable time."*

The judge found that the engineer was entitled to issue the clause 15.1 notices to correct and made some general points on their limits:

1. He adopted a commercially sensible construction, stating that clause 15.1 relates only to more than insignificant contractual failures by the contractor (such as a health and safety failure, bad work or serious delay on aspects of the work), which he said must be an actual failure to comply with the Contract rather than something that may have not yet become a failure. Whilst his approach is to be encouraged it cannot be ignored that, on its face, the express wording *'any obligation'* is very broad indeed and it may remain open to argument in other forums and jurisdictions that a failure to carry out any obligation need not be an important or material obligation.
2. The time specified for compliance in the clause 15.1 notice must be reasonable in all the circumstances at the time of the notice. The judge gave the example that if 90% of the workforce had gone down with cholera at that time, the period given for compliance would need to take that into account, even if that problem was the contractor's risk. He said that whether the notice came of the blue or if the subject matter had been raised before and the contractor had chosen to ignore what it has been told might also be relevant.
3. The contractor is given an opportunity and a right to correct any previous and identified contractual failure under clause 15.1.
4. Clause 15.1 notices must be construed strictly but may be construed against the surrounding facts given the potentially serious consequence of non-compliance.

Had the employer been right in terminating the contract under Clause 15.2?

The Court then reviewed clause 15.2 the contract, which states:

"15.2 The Employer shall be entitled to terminate the Contract if the Contractor:

> *(a) fails to comply…with a notice under Sub-Clause 15.1…*
>
> *(b) …plainly demonstrates the intention not to continue performance of his obligations under the Contract,*
>
> *(c) without reasonable excuse fails:*
>
> > *(i) to proceed with the Works in accordance with Clause 8…or;*
> >
> > *(ii) …*
> >
> > *In any of these events or circumstances, the Employer may, upon giving 14 days' notice to the Contractor, terminate the Contract and expel the Contractor from Site.'.*

The employer served a notice of termination on the grounds set out in clauses 15.2(a), (b) and (c), and the judge concluded that the Contract was lawfully terminated by the employer on these grounds.

Clause 15.2(a)

The judge found that the employer was entitled to serve a notice of termination under clause 15.2(a) because of the contractor's failure to remedy the defaults notified in the clause 15.1 notices to correct. The contractor's right to redesign the tunnel (if it so wanted) did not outweigh its obligation to get on with the works.

Clause 15.2 (b)

The judge found that the employer was entitled to serve a notice of termination under clause 15.2(b) because the contractor had plainly demonstrated an intention not to continue with the performance of its obligations under the contract. He

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distinguished between an intention to continue performance and an intention to continue performance of the contractual obligations. A clear intention to perform, but not by reference to important contractual terms, could demonstrate such an intention. Whilst this can be judged by reference to both words and actions, a simple disagreement between parties about what the contract meant, or disagreement about whether the contractor had some claim entitlement, would in itself not demonstrate such an intention.

Clause 15.2(c)

The judge found that the employer was entitled to serve a notice of termination under clause 15.2(c)(i) because the contractor had failed to proceed with the works with due expedition and without delay and had thus failed to proceed in accordance with clause 8.1 without reasonable excuse.

Additionally, the fact that liquidated damages are permitted for the failure by the contractor to complete on time, does not qualify the right to terminate under clause 15.2 for failure to proceed with due expedition and without delay, as these are two separate remedies.

Finally, in respect of clauses 15.2(b) and (c), the judge said that:

1. The test must be objective. So, if the contractor privately intended to stop work permanently but continued openly and assiduously to work hard at the site, this would not of itself give rise to a plain demonstration of intention not to continue performance. Similarly, if the contractor was, and had for many months been doing no work of any relevance without contractual excuse, this could give rise to a conclusion that it had failed to proceed with due expedition and without delay.
2. The grounds for termination must relate to significant and more than minor defaults on the part of the contractor.

Do termination events have to be repudiations?

The wording in clause 63.1 of the old FIDIC Red Book 1987 expressly permitted the employer to terminate the employment of the contractor where the engineer certified to the employer, with a copy to the contractor, that in its opinion the contractor had *'repudiated the Contract'*. However, this wording was deleted from the FIDIC 1999 editions and did not apply to this contract.

Nonetheless, the contractor argued that, *where 'a contract contains a provision such as clause 15.2 which entitles an employer to terminate by reason of a failure to remedy a breach of contract which has been the subject of a clause 15.1 notice (or to terminate by reason of a breach of contract such as one of those of the type identified in clause 15.2(b) and (c)) the breach of contract that is relied upon must be serious and one which is analogous to a repudiatory breach of contract'*[2]. The judge disagreed and said that this goes too far for a number of reasons:

1. Each contract must be considered on its own terms. For example, if the termination clause allows for termination 'for any breach of contract no matter how minor', the meaning is clear and does not require some repudiatory breach.
2. The contract lists grounds on which termination can take place including clause 15.2(b) which is not unlike the test for English common law repudiation. This ground is different from the other grounds, such as clause 15.2(c)(i). The contract would not include both, unless they are or can be, two separate grounds.
3. The cases relied upon by the contractor had a relatively simple right to terminate, where termination might come out of the blue. Under clause 15.2(a) there was a warning mechanism whereby termination could be avoided by the contractor's compliance with the clause 15.1 notice. Therefore, the contractor has the chance to avoid termination.

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4. The correct proposition that determination clauses will generally be construed as permitting termination for significant or substantial breaches and not trivial, insignificant or insubstantial ones is set out in Hudson's *Building and Engineering Contracts*[3].

What if the contractor is prevented or hindered from remedying its failure?

Although there was no suggestion that the employer had hindered or prevented the contractor, the judge stated that clauses 15.1 and 15.2(c) must, as a matter of common sense, give the contractor an opportunity to remedy the failure of which it is given notice.

Therefore, termination could not legally occur if the contractor has been prevented or hindered from remedying the failure for which the notice is given within the specified reasonable time. The judge gave the example of an employer who, following the service of a clause 15.1 notice, denies site access to the contractor to enable it to put right the notified failure. The employer should not be entitled to rely on its own breach to benefit by terminating.

Is it fatal to serve notice of termination on the 'wrong' address?

Clause 3.1(b) provided that notices were to be:

> *'Delivered, sent or transmitted to the address for the recipient's communications as stated in the Appendix to Tender.'*

The clause 15.2 notice of termination was sent by the employer to the contractor's site office rather than to the contractor's Madrid office, which was the address specified in the Appendix to Tender. The contractor argued that it was therefore invalid and ineffective, and wrote stating that this amounted to a repudiatory breach of the contract and purported to accept such repudiation.

The judge disagreed and concluded that the employer's notice of termination was a valid and effective notice. Although the Madrid office was given in the Appendix to Tender, he noted that throughout the project, correspondence (including the notices to correct) had been sent to the contractor's site office without any objection. The project was being run from the site office which was handling the bulk of the correspondence, and the project manager, with very substantial authority, was based there. In these circumstances the parties operated as if the site office was an appropriate address at which service of notices could be effected.

The judge drew the following conclusions when finding that service of the termination notice to the wrong address was not fatal:

1. Termination of the parties' relationship under such contracts is a serious step. The contractual provisions need to be complied with to achieve an effective contractual termination.
2. As a general rule, where notice has to be given to effect termination, it needs to be in sufficiently clear terms to communicate to the recipient clearly the decision to exercise the contractual right to terminate.
3. It is a matter of contractual interpretation tempered with commercial common sense (i) as to the requirements for the notice, and (ii) whether each and every specific requirement is an indispensable condition without compliance with which the termination cannot be effective.
4. Neither clause 1.3 nor clause 15.2 used words which would give rise to any condition precedent or making the giving of notice served only at the contractor's Madrid office a pre-condition to an effective termination. The key is to ensure that the contractor is actually served with a written notice, receives the notice, it is clear and unambiguous and that it is being served under clause 15.2.
5. The primary purpose of clause 1.3 is to provide an arrangement whereby notices, certificates and other communications are effectively dispatched to, and received by, the contractor. The primary purpose of a clause 15.2 notice is to ensure that the contractor is made aware that its continued employment on the project is to end.

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6. The service of a termination notice at the contractor's Madrid office was not an indispensable requirement either of clause 15.2 or clause 1.3. Provided that service of a written clause 15.2 notice was actually effected on the contractor's affiliates at a sufficiently senior level, then that would be sufficient service to be effective.

Did the service of the termination notice to the 'wrong' address amount to a repudiation?

The judge said that the service of an otherwise valid and actually well-founded termination notice at the technically wrong address could not in law and on the facts of this case, amount to repudiation. Therefore, the contractor was not entitled to treat what was otherwise a legally and factually proper termination notice as a repudiation (as it purported to do). Consequently, the contractor had itself repudiated the contract by wrongfully treating the contract as at an end, even though it was not accepted as such by the employer.

However, by choosing to re-deliver the notice of termination via courier to the contractor's Madrid office, the employer elected to treat the contract as continuing. Thus, had this redelivered notice had been necessary, the contract would have been terminated 14 days later contractually, as opposed to an accepted repudiation.

The judge found that given the employer took the contractual route of termination it was not entitled to elect to accept the contractor's repudiatory conduct.

When do the 28 days under clause 20.1 start to run?

Clause 20.1 states:

> *'If the Contractor considers himself to be entitled to any extension of the Time for Completion…under any Clause of these Conditions or otherwise in connection with the Contract, the Contractor shall give notice to the Engineer, describing the event or circumstance giving rise to the claim. The notice shall be given as soon as practicable, and not later than 28 days after the Contractor became aware, or should have become aware, of the event or circumstance.*
>
> *If the Contractor fails to give notice of a claim within such period of 28 days, the Time for Completion shall not be extended, the Contractor shall not be entitled to additional payment, and the Employer shall be discharged from all liability in connection with the claim. Otherwise, the following provisions of this Sub-Clause shall apply…'*

The judge said that properly construed and in practice, the *'event or circumstance giving rise to the claim'* for an extension of time must first occur and there must, second, have been either awareness by the contractor or the means of knowledge or awareness of that event or circumstance before the condition precedent bites. Given the potential serious effect on what could otherwise be good claims for instance for breach of contract by the employer, he did not believe that the clause should be construed strictly against the contractor but that it should be construed reasonably broadly.

In considering when the event or circumstance giving rise to the extension of time claim arose, regard was had to clause 8.4 which identifies when and in what circumstances such extension of time will be granted:

> *'The Contractor shall be entitled subject to Sub-Clause 20.1…to an extension of the Time for Completion if and to the extent that the completion for the purposes of Sub-Clause 10.1…is or will be delayed by any of the following causes…'*

This led the judge to conclude that the entitlement to an extension of time arises if, and to the extent that, the completion *'is or will be delayed'* by the various events. He said that the extension of time can be claimed either when it is clear that there will be delay (a prospective delay) or when the delay has at least started to be incurred (a retrospective delay).

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He explained (through the use of an example) that the wording in clause 8.4 is not *'is or will be delayed whichever is the earliest'* so that notice does not have to be given for the purpose of clause 20.1 until there is actually delay although the contractor may give notice with impunity when it reasonably believes that it will be delayed. Determining when delay is actually suffered should not be difficult where a critical path programme is used.

His view on this point favours the contractor and may not be shared by employers. If a contractor is *'clear that the Works overall will be delayed'* and considers it will be entitled to an extension of time, why should that contractor refrain from giving notice until there is actual delay? Clause 20.1 expressly states that notice be given *'as soon as reasonably practicable, and not later than 28 days after the Contractor became aware, or should have become aware of the event or circumstance'*. Arguably, knowing that delay will occur but waiting until it has actually been incurred runs contrary to this requirement and will defeat the advantages to the employer of the early warning.

The judge was considering an extension of time claim but the logic would seem to apply equally to the money: the event or circumstance can mean either the incident or the incurring of cost which results or will inevitably result from the incident. Where an incident gives rise to both delay and cost which occur at different times would notice have to be given within 28 days of the occurrence of whichever came first? If that opportunity was missed, would a notice when the second consequence occurred save the contractor's ability to claim in relation to the second consequence, both consequences, or neither?

Clause 20.1 does not stipulate any particular form and the judge said one should construe it as permitting any claim provided that it is (i) made by notice in writing to the engineer, (ii) the notice describes the event or circumstance relied on, (iii) the notice is intended to notify a claim for extension of time (or for additional payment or both) under the contract or in connection with it, and (iv) it is recognisable as a *'claim'*. It is worth noting here that under the express wording of clause 20.1 the notice is of the contractor's entitlement to time and/or money with a description of the event or circumstance giving rise to the claim. It is not the claim itself which follows later.

Conclusion text

This case is a useful reminder of the powers available to employers under the FIDIC Yellow Book to terminate the contracts of contractors who drag their feet. It gives common sense advice on the address for service of notices and provides useful, albeit brief and possibly controversial, guidance on clause 20.1 notices.

It is to be hoped that more foreign parties will bring their disputes to the specialist expertise of the Technology and Construction Court for resolution in the future.

[1] Paragraph 332.

[2] Paragraph 322.

[3] Twelfth Edition at para 8.056.

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