BCLP. Client Intelligent

Insights

FIDIC THE DISRUPTOR: LIQUIDATED DAMAGES TO COMPENSATE THE CONTRACTOR FOR EMPLOYER DELAY

Feb 01, 2021

SUMMARY

Whether it's the electric motor to the combustion engine or cryptocurrency to currencies, every industry seems to have a disruptor – perhaps we've found one in FIDIC for the construction industry and its re-imagining of the use of liquidated damages (LDs) in the soon-to-be published Green Book.

The special pre-release version of the new edition Green Book was revealed to delegates at the virtual FIDIC 2020 International Contract Users' Event. The Green Book is for relatively small value projects – the World Bank recommends its use in projects valued up to US$10m (FIDIC itself sets no upper-limit). The key provisions of the Green Book, together with other exciting announcements from FIDIC are summarised in my colleague, Natalie Wardle's, excellent blog, FIDIC contracts – a preview of what is to come.

The new edition introduces LDs to compensate the contractor for employer culpable delay alongside traditional "delay damages" to compensate the employer for contractor culpable delay. Should we now expect to see as commonplace LDs for, as FIDIC put it, "Prolongation Costs"?

How it works

Where a contractor is entitled to an extension to the Time for Completion (EOT) as well as Cost or Cost plus Profit (which is now set out in a useful Employer's Risks table listing risks and their consequences), the contractor is entitled to "Prolongation Costs" for the duration of the relevant EOT. Prolongation Costs are defined as on-Site and off-Site overheads associated with a "compensable EOT". So we are talking about the compensation of preliminaries for delay.

Unlike employer's LDs for contractor delay, which are usually calculated pursuant to a pre-agreed daily or weekly rate, Prolongation Costs are calculated pursuant to a pre-agreed formula including:

- The value of the Works carried out at the time of the delay event, as certified by the Engineer; and
- The average “Weight” of the on-Site and off-Site overheads per day.

The new regime has the potential to up-end some long established principles. First, the rule that prolongation costs do not automatically follow an EOT no longer applies where the Green Book says the contractor is entitled to an EOT and Cost or Cost plus Profit. Secondly, and perhaps more interestingly, the position in common law jurisdictions that a contractor is entitled to time but not money where there is concurrent delay. Under the Green Book that may no longer be the case: where Cost or Cost plus Profit automatically follows an EOT, the contractor may be entitled to time and money notwithstanding any concurrent delay.

Clear benefits

The usual advantages of LDs equally apply to pre-determined damages arising from employer culpable delay:

- It brings certainty to both parties about the consequences of the specific breach. Both parties will know how much is due to the contractor for any employer culpable delay.
- It limits the liability of the employer. Sub-clause 1.1.35 of the Green Book states:

Prolongation Costs shall be the only compensation due from the Employer to the Contractor for an EOT resulting from a compensable delay.

As is typically the case for LDs arising from contractor delay, the employer is not liable for any further costs relating to its culpable delay beyond the pre-agreed Prolongation Costs. Interestingly, sub-clause 1.1.35 expressly carves out “other Costs” and “disruption Costs“:

For the avoidance of doubt, this provision shall not affect Contractor’s compensation rights for other Costs (if any), such as disruption Costs (if any)

This must be right. As the SCL Protocol on Delay and Disruption makes very clear, delay-related losses are distinct from disruption-related losses (and not necessarily predicated on delay). It's not entirely clear what is meant by "other Costs", distinct from Prolongation Costs and disruption Costs, but they may include the non-delay and disruption related Costs arising from the delay event. No doubt the employer/engineer will carefully assess all claimed Costs to ensure no double-recovery of Prolongation Costs for which LDs are the exclusive remedy.

- It saves time and expense in disputes. One of the main advantages of pre-agreed damages is that it dispenses with the need for the contractor to establish actual loss and a causal link between that loss and the delay. Establishing loss and causation involves lengthy preparation and often expert evidence that translates to increased time and complexity in already costly legal proceedings. The use of LDs should, in theory, bring those costs down.

Will it catch-on?

Despite its clear advantages, I'm sceptical that pre-agreed damages for employer delay is about to catch-on for larger value construction contracts. The savings in time and expense in disputes are limited: dispensing with the relative complexities of quantifying damages does not do away with the need to establish liability for the delay itself. Unless the cause of delay is clear-cut, there will usually be a dispute over the causes and responsibility for the delay. In my experience, establishing responsibility for delay is often more time-consuming, factually intense and, throw-in concepts like concurrent delay, complex than quantum.

Traditionally, where the contractor is culpable for delay, it can expect to be liable for LDs. If that is also the case for the employer, disputes over culpability for delay will not disappear – if anything they may intensify.

The pre-agreed formula also strikes me as susceptible to disputes. A key part of the formula is the valuation by the Engineer of the works that have been carried out at the time of the event (which appears to effect the value of the Prolongation Costs). For smaller projects, the Engineer's valuation may not have a material effect on the level of compensation but this may not be the case for larger-value projects where the value of completed works may be a contentious issue in and of itself.

Unless carefully drafted, and depending on the governing law of the contract, LDs for employer delay may be open to challenge. In England and Wales, an LDs clause may be ousted if it falls foul of the rule against penalties (see El Makdessi v Cavendish Square Holdings BV). In many jurisdictions in the Middle East, the rate of LDs may be revised up or down where actual loss is different (often with a requirement to prove a significant difference) from the rate pre-agreed. It is therefore important that the rate or formula set out in the contract represents the contractor's likely losses or legitimate commercial interests. Easier said than done where a contractor's on and off-site overheads will almost certainly fluctuate as the project progresses.

FIDIC's Green Book addresses these concerns by adjusting the applicable rate of Prolongation Costs where the value of the Work is at 0%, 33% and 66% of the Contract Value, respectively. Such adjustments are probably suitable for lower-value works (such as those anticipated by the Green Book) but may not be appropriate for larger-value complex projects, with multiple sections of work that are likely to have differing on and off-site overheads as various phases of the works advance.

There's also the point whether the industry wants or needs more LDs. For example, in the Middle East, nearly all construction contracts include employer's LDs for contractor delay, usually capped at 10% of the contract price (I'm not sure why 10% is seen as adequate for all projects – in some cases, 10% of the contract price is not enough to compensate an employer). Almost all large-scale projects are delayed (and in the current market, there is no rush to complete projects) resulting in an almost guaranteed 10% discount to the contract price. It is such a certainty that there's a sense that contractors build the 10% reduction in to the original price. I wonder whether dispensing of LDs altogether, and relying instead on general damages, would better serve parties and get closer to compensating them for the losses that LDs were meant to address – but that's a different blog.

Conclusion

Maybe I'm too cynical. Maybe the advantages of LDs, including the certainty it gives parties, outweigh the issues outlined above. Or maybe the fundamental change the industry needs is not more LDs but dispensing with the ones we already have.

One thing is for sure, the new edition of the Green Book, which takes the best parts of the 1999 and 2017 suite of FIDIC contracts, looks like an improvement over the original and so we may see the new version increasingly used with parties testing the innovative LDs regime.

This article first appeared on the Practical Law Construction blog dated 27 January 2021.

RELATED CAPABILITIES

- Real Estate
- Construction Disputes

MEET THE TEAM

Richard Dupay

Dubai

richard.dupay@bclplaw.com
+971 2 652 0329
