WITH COMPLIMENTS

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FIDIC:

"THE GOLDEN HANDCUFFS"

Natalie Reyneke reveals some pitfalls and solutions to the use of the Fidic Gold Book.

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My colleague, Taryn Van Deventer, recently wrote an article for FAFC entitled "The Gold Book - a quick Introduction". This article did it's job – it gave an overview of the FIDIC Gold Book and highlighted some of the instances where the Gold Book differs from the Red, Yellow and Silver Books. I enjoyed that article when I read it, having had little experience in any dealings with the Gold Book. Little did I know, that my luck was about to change. All in one go, I received 3 new instructions from Employers who were either having issues with their Contractors appointed under the Gold Book, or wanting to enter into a Gold Book with a potential Contractor. I must say that being thrown into the deep end works well and has given me the knowledge and insight into some of the flaws that are found in the Gold Book – particularly for Employers, and enabled me to share these experiences with you. The long and the short of it is - Employer's may find themselves saddled with their Contractor with little option but a painful separation – or a pair of "Golden Handcuffs" if you like, for a period of 20 years! That may sound exciting for our S&M fans, but not so much for most Employers.

The Gold Book, as we know, is used in the unique situations where the Contractor designs, builds and then operates the plant that he has designed and built for an extended period of time. The object of the contract to is to enable the Contractor to provide to the Employer a certain output of whatever it is that the plant is designed to give. This results in a contract that has to cover the design – build phase and then the operational phase all in one. The contract data is completed by the parties right in the beginning, before the commencement of the design – build phase. What this means, is that there is quite a lot of information that is required to be included in the contract to ensure that each and every aspect has been thought of and covered somewhere in the numerous pages that constitute the final contract. But this is not always done as comprehensively as it should be.

Picture this - the Contractor designs and builds the plant. It passes the tests on and after completion and for 3 years is running smoothly. All of a sudden there is a change of management of the Contractor and it's service starts slipping - they are taking short cuts to save costs, and quite frankly, the plant is not providing the production outputs required to enable the Employer to meet the requirements of his off-take agreements. Now what? There must be a remedy in the Contract. Ah yes, there it is – Clause 10.7. (Phew!!)

Clause 10.7 provides:

"In the event that the Contractor fails to achieve the production outputs required under the Contract, the Parties shall jointly establish the cause of such failure.

a) If the cause of the failure lies with the Employer or any of his servants or agents then, after consultation with the Contractor, the Employer shall give written instruction to the Contractor of the measures which the Employer requires the Contractor to take. If the Contractor suffers any additional cost as a result of the failure or the measures instructed by the Employer, the Employer, subject to Sub-Clause 3.5 [Determinations] and Sub-Clause 20.1 [Contractor's Claims], shall pay the Contractor his Cost plus Profit.

b) If the cause of the failure lies with the Contractor then, after due consultation with the Employer, the Contractor shall take all steps necessary to restore the output to the levels required under the Contract.

If the Employer suffers any loss as a result of the failure or the measures taken by the Contractor, the Contractor, subject to Sub-Clause 3.5 [Determinations] shall pay the employer the performance damages specified in the Contract Data.

Unless otherwise stated in the Contract Data, if the failure continues for a period of more than 84 days and the Contractor is unable to achieve the required production output, the Employer may either:

i) Continue with the Operation Service at a reduced level of compensation determined in accordance with Sub-Clause 3.5 [Determinations]; or

ii) If the production outputs fail to reach the minimum values required in the Contract Data, give notice to the Contractor not less than 56 days prior to terminating the Contract, in accordance with Sub-Clause 15.2 [Termination for Contractor's Default]. In such an event, the Employer shall be free to continue the Operation Service himself or by others."

So where do we start? Firstly, the Contractor has to have failed to achieve the production outputs required under the contract. This implies that the production outputs need to be comprehensively dealt with in the contract (usually found in the Employer's Requirements document). Once this failure is established, the Employer and the Contractor have to jointly establish the cause of such failure. This is a strange provision to have in a contract when both parties know that the outcome of such discussions will have financial implications on at least one of the parties if they agree that they have caused the failure!

How would one resolve this impasse? Unlike the other standard form FIDIC contracts, the Gold Book contains a definition of what a Dispute is. The definition of a "Dispute" (which, during the Operation Services Period is resolved pursuant to Clause 20.10 of the contract):

"any situation where a) one Party makes a claim against the other Party; (b) the other Party rejects the claim in whole or in part; and (c) the first Party does not acquiesce, provided however that a failure by the other Party to oppose or respond to the claim, in whole or in part, may constitute a rejection if, in the circumstances, the DAB or the arbitrator(s) as the case may be, deem it reasonable for it to do so".

I must admit this reads like French to me, and I had to look up the meaning of the word "acquiesce". It means to accept something reluctantly but without protest. To me, the definition of Dispute excludes the situation where the Parties cannot agree as to who caused the failure as envisaged in Clause 10.7. This is issue number one.

Now on to issue number two. Let's say the Parties do agree that it was the Contractor that caused the failure. Clause 10.7(b) then applies. The Contractor is required, in consultation with the Employer, to restore the output to the levels required in the Contract. If the failure continues for a period of more than 84 days and the Contractor is unable to achieve the required production output, the Employer then has a choice to either:

- continue at a reduced level of compensation (this doesn't help if the Employer has offtake agreements to honour); or
- if the production outputs fail to reach the minimum values required in the Contract Data, give notice to the Contractor not less

than 56 days prior to terminating the Contract in accordance with Sub-Clause 15.2.

Sub-Clause 15.2 lists the instances (events or circumstances) where the Employer is entitled to terminate the Contract. Neither of these instances refer to Clause 10.7. In addition, paragraph 2 of Sub-Clause 15.2 requires the Employer to give the Contractor a 14-day notice period to cure the event or circumstance. This is in contradiction to Sub-Clause 10.7, which requires a 56-day notice period.

If we further unpack paragraph (b)(ii) of Sub-Clause 10.7 and in order for the Employer to get rid of the non-performing Contractor from the Site, there should be minimum values (in relation to production outputs) in the Contract Data (this is in addition to the production outputs required as outlined in the Employer's Requirements). Remembering that we have completed the Contract Data way back at the beginning of the Contract before the Design-Build even took place, this is a particular piece of the Contract puzzle that often remains incomplete or inadequate. The entitlement to terminate is NOT an option available to the Employer in terms of this Sub-Clause if the Contractor fails to achieve the production outputs required by the Contract. This option is, in fact, only available if the Contractor has to fail to achieve the minimum values required in the Contract Data. If this information is not detailed in the Contract Data, the entitlement to terminate will vanish and the Employer will be stuck with an underperforming Contractor who will suffer little more than a slap on the wrist and a reduced level of compensation.

In addition, there is the possibility for the Contractor to throw resources at the problem, with the aim of bringing the production outputs back to an acceptable level, only to relax again thereafter and bring the Employer straight back to square one.

What this experience has taught me is that an Employer who intends tying himself into a contract with a Contractor under the Gold Book, has to make sure that:

- If there is no agreement reached on who the cause of the failure to achieve the production outputs required under the Contract was, that there is the possibility to refer this dispute (that is not actually a defined dispute under the Contract) to a competent third party who can make the decision for the Parties, and quickly;
- Ensure than the Contract Data is completed correctly with specific reference to minimum production outputs required;
- Insist on a clause which caters for successive failures to achieve production outputs as required by the Contract – the Contractor should not be allowed to continuously fail to achieve and recover.

Not all is lost. Employers can hold the key to the Golden Handcuffs and they should ensure that this key is available to them before signing the Contract.