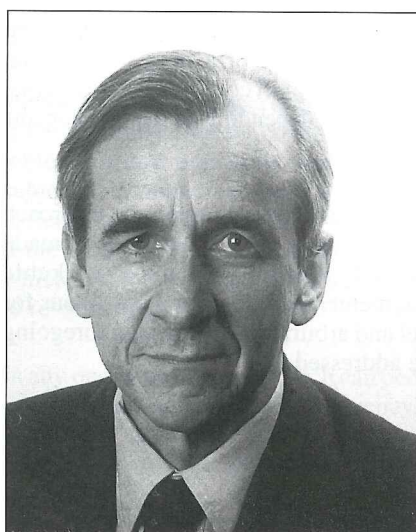


INTERNATIONAL CONSTRUCTION CONTRACT DISPUTES: COMMENTARY ON ICC AWARDS DEALING WITH THE FIDIC INTERNATIONAL CONDITIONS OF CONTRACT

By Christopher R. Seppala*



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This article is a brief commentary on extracts from twelve ICC awards dealing with disputes that have arisen in relation to the second (1969) and third (1977) editions of the "FIDIC¹ Conditions of Contract for Works of Civil Engineering Construction" (the "**FIDIC Conditions**"), published in the May 1998 and the current (November 1998) issue of this Bulletin.²

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¹ "FIDIC" refers to the Fédération Internationale des Ingénieurs-Conseils or (in English) the International Federation of Consulting Engineers, which has its head office in Lausanne, Switzerland.

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The FIDIC Conditions are the best known and probably most widely used international standard form of construction contract conditions. The first edition of this form, published in 1957, was based on an English domestic standard form: the English Institution of Civil Engineers (ICE) Conditions. However, in subsequent editions (a second edition published in 1969, a third in 1977 and a fourth in 1987), the FIDIC Conditions have become progressively more "international" in style and content, while retaining a Common Law orientation.

Since the first edition, the FIDIC Conditions have provided for roughly the same procedure for the resolution of disputes. Disputes have had first to be referred to "the engineer"³ for decision and, if the contractor or employer did not accept his decision, to arbitration. The FIDIC Conditions have always provided for ICC arbitration although the parties are, of course, free to replace it with another system of arbitration if they prefer.⁴

Beginning with the construction boom in the oil producing countries, which followed the quadrupling of world oil prices in 1973, the FIDIC Conditions became widely used internationally, especially in the Middle East. Given the complexity of international construction projects and the high risks (and profits) they often entail, construction contracts incorporating the FIDIC Conditions (as well as other conditions) gave rise to a significant number of ICC arbitrations in the period 1980 to 1995. Construction disputes represented over 20 per cent of the cases submitted annually to ICC arbitration in the 1980s. While their importance has diminished, they continued to represent approximately 14 per cent of the cases submitted to ICC arbitration in 1997.⁵

³ Under the FIDIC Conditions, the engineer is a person who is appointed by the employer (or owner) to supervise, among other things, the work of the contractor and decide disputes between the employer and the contractor, at least on an interim basis. The engineer may also have designed the works.

⁴ Unlike FIDIC's Conditions for Works of Civil Engineering Construction, the FIDIC Conditions of Contract for Design-Build and Turnkey (the "**Orange Book**") published in 1995 do not propose any particular form of arbitration in Part I but provide for ICC arbitration as an option, among others, in Part II.

⁵ See Vol. 9/No. 1, *ICC International Court of Arbitration Bulletin*, May 1998, p. 8.

A first series of ICC awards dealing with construction contracts referring to the FIDIC Conditions was published in Vol. 2, No. 1 of this Bulletin in 1991. While ICC awards dealing with the FIDIC Conditions have also been published elsewhere,⁶ the awards published in the May and current (November) issues of this Bulletin constitute the second series of ICC awards dealing with this subject to appear in this publication.

Although none of the awards in this second series deals with disputes under the current fourth (1987) edition of the FIDIC Conditions, and the fourth edition resolved certain of the issues raised by these awards, they nevertheless contain decisions of interest to practitioners of international commercial arbitration. While the emphasis in this commentary will be on rulings of current interest, the third (1977) edition of the FIDIC Conditions continues in use (e.g., in construction contracts for Russia's major program for the building of housing for Russian troops that have returned from Germany) and, therefore, is, and is likely to continue to be, the subject of arbitrations for years to come. While a number of awards in this second series deal with the procedure for the resolution of disputes by the engineer under Clause 67 of the FIDIC Conditions (as discussed below), and while the engineer is progressively being replaced in this role by a Dispute Adjudication Board,⁷ rulings in relation to the resolution of disputes by the engineer may remain relevant to the resolution of disputes by the Board. Thus, awards dealing with the second (1969) and third (1977) editions of the FIDIC Conditions can continue to be of current interest.

⁶ For other ICC awards dealing with the FIDIC Conditions, see, among other sources: (i) the *Collections of ICC Arbitral Awards*, 1974-1985 (Vol. I), 1986-1990 (Vol. II) and 1991-1995 (Vol. III) edited by different editors and published by ICC Publishing S.A., Kluwer Law International; (ii) *The International Construction Law Review*, Vols. 1 to 3 (1983-86) and Vol. 6 (1989) published by Lloyds of London Press, Ltd.; and (iii) the *Yearbook Commercial Arbitration*, published by Kluwer Law and Taxation Publishers.

⁷ See Supplement to fourth edition 1987 of "Conditions of Contract for Works of Civil Engineering Construction" published by FIDIC in 1996 and providing, among other things, for a Dispute Adjudication Board as an "acceptable alternative" to the engineer's role in dispute resolution. See also Seppala, "The FIDIC Provision for a Dispute Adjudication Board" published in *The International Construction Law Review (ICLR)* (London), 1997, p. 443, and in English and French in *RDAl/IBLJ* (Paris), No. 8, 1997, p. 967.

The awards in this second series deal principally with six subjects, as follows:

- (1) Clause 67, the disputes clause in the FIDIC Conditions,
- (2) Multi-party arbitration and, in particular, whether a contractor, who has a dispute with its subcontractor, may join the subcontractor in an arbitration between the contractor and the employer,
- (3) "Pay when paid" clauses in subcontracts,
- (4) Termination of the contractor for default (Clause 63),
- (5) Damages that are payable where an advance payment is paid late, and
- (6) Whether the FIDIC and ENAA forms constitute trade usages.

I will comment on the awards below by reference to these six subjects.

I - CLAUSE 67, THE DISPUTES CLAUSE IN THE FIDIC CONDITIONS

Of the twelve awards published in this and the previous issue of the Bulletin, no fewer than eight deal in whole or in part with issues under Clause 67. This confirms – if confirmation were necessary – how important it has always been for the parties (and, in particular, the contractor, who will usually be the claimant) to understand and comply strictly with the pre-arbitral procedure set out in that clause⁸ before commencing arbitration.

It will be recalled that, under the FIDIC Conditions, third edition, Clause 67 provided for, basically, a four-step procedure to be followed before a matter could be submitted to arbitration:

- (i) A "dispute or difference" had to exist between the employer (or the engineer) and the contractor as to such matter, e.g., this might

⁸ For a commentary on Clause 67 in the FIDIC Conditions, third edition, see Seppala, "The Pre-Arbitral Procedure for the Settlement of Disputes in the FIDIC (Civil Engineering)

be the case where a claim of the contractor had been rejected by the engineer, acting on behalf of the employer;

- (ii) The dispute must have been referred to the engineer for decision;
- (iii) The engineer must have decided the dispute, or failed to take a decision, within 90 days of the referral; and
- (iv) Within 90 days of the engineer's decision, or of the expiry of the 90-day period for the engineer to act, the contractor could require the dispute to be referred to ICC arbitration; otherwise, the decision, if any, of the engineer would become "final and binding" on the parties.

The eight awards dealing with Clause 67 concern a number of different issues dealing with this clause, as discussed below.

A. Where the employer has never appointed an engineer, may the contractor proceed directly to arbitration (cases No. 6276 and 6277 [1990])?

In case Nos. 6276 and 6277 [1990], the employer appears never to have appointed an engineer in the usual way. Instead the functions of the engineer (other than in relation to the settlement of disputes under Clause 67) had been performed by various individuals or "collective organizations", varying according to the circumstances. In this situation, the claimant (the contractor) concluded that it was relieved from having to refer disputes to the engineer under Clause 67 as the employer had never notified it in writing of the name of the engineer who was specifically authorized to discharge that pre-arbitral function.

However, the arbitral tribunal disagreed, stating that:

"the Claimant... was under a duty to put the Defendant (Employer) on notice to indicate to it the name of the Engineer to whom the dispute

Conditions of Contract," *ICLR*, 1986, p. 315, and in English and French in *RDAl/IBLJ* (Paris), No. 6, 1987, p. 579, and Wallace, "The Time Bar in FIDIC Clause 67," *ICLR* 1985, p. 330.

could be submitted. It was only if it had met with a refusal or in the event of the failure to reply on the part of the Defendant that the Claimant could have been dispensed from complying with this pre-arbitral phase."

Accordingly, the tribunal concluded that the claimant had not satisfied the pre-requisite for arbitration set forth in Clause 67 and, consequently, that the request for arbitration was "premature." The tribunal stated that the claimant should have demanded that the defendant (employer) designate an engineer to whom to submit the dispute before it came before the tribunal.

This case illustrates again how important it is for the claimant (usually, the contractor) to ensure that it has satisfied all conditions to arbitration before embarking on such a proceeding. Otherwise, it runs the risk that, after months if not years of arbitral proceedings, its request for arbitration will be dismissed as "premature," resulting not only in loss of time and expense for the claimant but handing an important psychological victory to the defendant.

B. What is required in order for a party to make a valid submission to the engineer under Clause 67 (cases No. 6238 [1989] and 6535 [1992])?

Two cases deal with different aspects of this issue: case Nos. 6238 [1989] and 6535 [1992].

Case No. 6535 [1992] dealt with the question of whether a "dispute" must exist as to a matter before such matter may be referred to the engineer for decision under Clause 67. In that case, the contractor had sent certain letters to the engineer claiming relief under specified provisions of the FIDIC Conditions, namely, Clause 44 (dealing with applications for extension of time) and Clause 52 (dealing with payment for variations). The contractor asked the tribunal, nevertheless, to consider these letters as amounting to referrals of disputes to the engineer for his decision under Clause 67. Quite properly, the tribunal refused to do so, stating that:

"before a claim or contention can constitute a dispute to be referred under Clause 67, it must first have been submitted and rejected under the contract. It follows that if the matters

submitted to the Engineer are claims which have not previously been rejected, they cannot be regarded as submitted under Clause 67 whatever language is used in the submission."
[Emphasis added]

As the claims had not been submitted to the engineer and been rejected by him (thereby constituting "disputes"), before the contractor had invoked Clause 67, the tribunal held that the contractor had not complied with Clause 67 and that, therefore, the tribunal had no jurisdiction over the claims advanced.

The consequence of this decision was fairly dramatic for the contractor, as it resulted in the dismissal of 216 claims which the contractor had sought to refer to arbitration. Of course, nothing would prevent the contractor thereafter from complying with Clause 67 in relation to its claims. If the contractor did so, and if the contractor were dissatisfied with the decision or decisions, if any, of the engineer on such claims, and if the contractor properly reserved its right to refer them to arbitration, the contractor would have the right to have such claims considered in a new ICC arbitration.

In case No. 6238 [1989], there was no issue between the parties over whether a dispute existed. The existence of a dispute was assumed. Instead, the issue was what constitutes a valid submission to the engineer under Clause 67 of the FIDIC Conditions, third edition. The award quite correctly states that any submission to the engineer under Clause 67 **must clearly refer a dispute for him to decide under the clause**; it is not sufficient for a party merely to indicate an intention to submit a dispute to the engineer at a later point in time.

As was stated by Judge Harman in the English case *Monmouthshire CC v. Costelloe & Kemple*,⁹ Clause 67 is a clause which can cause a party to forfeit its legal rights (namely, its right to arbitration or litigation) if the time periods, beginning with the referral of a dispute to the engineer, are overlooked. Accordingly, when invoking the Clause, a party should clearly inform the other party that it is doing so in order that the other party should not forfeit its rights inadvertently.

⁹ (CA 1965) 5 *Building Law Reports*, 83, 91.

Under the fourth edition, all ambiguity on this point has been removed: the referring party must expressly state that it is referring a dispute to the engineer pursuant to Clause 67. Consequently, the other party is left in no doubt that Clause 67 is being invoked and, thus, that the time periods under the clause are beginning to run.

C. What action was a party obliged to take under Clause 67 in order to preserve the right to submit a dispute to arbitration (cases No. 7641 [1996], and 5948 [1991])?

Nothing gave rise to more controversy, under the second and third editions of the FIDIC Conditions, than the question of what action a party was obliged to take in order to ensure its entitlement to be able to submit to arbitration a dispute which it had previously referred to the engineer under Clause 67.

Under Clause 67, if the engineer had failed to give a decision within 90 days or if either party was dissatisfied with his decision, then either party could, within 90 days of receiving the decision or within 90 days of the expiration of the first-named period of 90 days, as the case may be, "require that the matter or matters in dispute be referred to arbitration." Clause 67 then provided that any arbitration was to be conducted under the ICC Rules.

The question therefore was what action precisely a party had to take in order to be able to "require" that a dispute be referred to arbitration. Did the obligation to "require" that a matter in dispute be referred to arbitration make it necessary to submit a request for arbitration to the ICC (which, under the ICC Rules, enables an ICC arbitration to begin), or was something less than submission of a request for arbitration sufficient to secure the entitlement to arbitrate and, if so, what? The question was an important one as, if a contractor had failed to take the correct action within the relevant 90-day period, it would be bound by the engineer's decision, if one had been rendered (e.g., dismissing the contractor's claim), or, if none had been rendered, it might forever be barred from being able to litigate or arbitrate the matter. Consequently, where the contractor's claims involved large sums of money (as was not uncommon), and where the engineer had issued a decision with which the contractor was dissatisfied (e.g., one dismissing the

contractor's claims), the outcome of this issue could be very important.

Having examined the issue in some detail,¹⁰ the author concluded that the arguments on this issue were quite evenly divided and, hence, counseled parties to err on the side of caution, that is, to submit a request for arbitration to the ICC. However, a number of parties did not take this precaution and, in some cases, suffered the consequences, as several arbitral awards held that it was necessary for a party actually to submit a request for arbitration to the ICC within the relevant 90-day period in order to be able to preserve the right to arbitrate the relevant disputes.¹¹

But in case No. 7641 [1996], which is included in this second series of ICC awards, the tribunal noted (correctly) that a majority of ICC awards rendered in cases involving the second and third editions had held that the actual commencement of arbitration was not required; it was sufficient if the claimant had notified the engineer of its (the claimant's) "intention" to arbitrate.

Another tribunal reached a similar conclusion in case No. 5948 [1991], which is also in this series, stating, as follows:

"Clause 67 is a clause containing provisions which potentially bar a party from exercising its legal rights within the time limits which the law would otherwise allow. Basically, therefore, to be effective its barring stipulations must be unambiguous. While the rival arguments have been dealt with extensively in many ICC awards... it seems to us that... a notification in writing by the aggrieved party to the Engineer that he requires that the dispute be referred to arbitration under the contract is sufficient to preserve the right thereafter to proceed to arbitration."

The difficulty dealt with by these cases was addressed in the fourth edition (1987), which makes it clear that to preserve the right to arbitrate,

it is sufficient to give a notice to the other party, with a copy to the engineer, of one's intention to commence arbitration.¹² There is no need actually to commence an arbitration.

D. Where a party had obtained a "final and binding" decision from the engineer, which the other party failed to comply with, whether the first party could refer such failure to arbitration (case No. 7910 1996)?

It was another unfortunate feature of Clause 67 of the second and third editions that it was unclear, where one party had obtained a favorable decision from the engineer which the other party had not contested and which, therefore, became "final and binding," what would happen if the other party failed to respect such decision, e.g., failed to pay the amount ordered to be paid by such decision. Could the first party refer such failure to arbitration in order to obtain an award in respect of such decision which could be internationally enforced under the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "New York Convention")?

The award in case No. 7910 [1996] addressed this issue. The arbitral tribunal concluded that, where the claimant had submitted disputes to the engineer under Clause 67 and obtained decisions from the engineer which had become final and binding because they had not been challenged by the defendant in due time, the arbitral tribunal was without jurisdiction with respect to such matters. The claimant's only remaining right of recourse was to seek to enforce the decision before the courts in the defendant's country.

This often left claimants in a highly undesirable position. Typically, the defendant would be a state or a state-owned entity of a developing country. If a claimant could not obtain an arbitral award in respect of a final and binding decision of the engineer (and so be entitled to the benefits of the New York Convention), it was usually difficult, if not impossible, to enforce such decision in the courts of the defendant's country. As a practical matter, therefore, these decisions were often unenforceable.

¹⁰ See Seppala "The Pre-Arbitral Procedure for the Settlement of Disputes in the FIDIC (Civil Engineering) Conditions of Contract," *supra*.

¹¹ See case No. 3790 [1983], 1 ICLR 372 (1983-84) and case No. 4707 [1986], 3 ICLR 470 (1985-86).

¹² See Clause 67.1, FIDIC Conditions, 4th ed.

Accordingly, the solution of the arbitral tribunal in the earlier ICC case No. 3790, which is cited to by the tribunal in case No. 7910 [1996], appears more satisfactory. In that case, the arbitral tribunal had awarded the contractor the amount of money claimed based on a final and binding decision.

At all events, the issue raised by case No. 7910 was resolved by the FIDIC Conditions, fourth edition. Sub-Clause 67.4 of that edition expressly provides that, where a decision has become final and binding, either party may, if the other party fails to comply with such decision, and without prejudice to any other rights it may have, refer the failure to arbitration directly, that is, without having to refer the failure back to the engineer under Clause 67. Consequently, a party can obtain an arbitral award in respect of such a decision.

E. Whether, where provisions of a main contract based on the FIDIC Condition are incorporated into a subcontract, the parties to the subcontract are bound by Clause 67, including the requirement of the referral of a dispute to the engineer before arbitration (cases No. 6611 [1992] and 7423 [1995])?

It is common practice for subcontracts to provide that provisions of the main contract are incorporated by reference in some manner into the subcontract. However, such incorporation is often not skillfully done with the result that, when a dispute arises under the subcontract which relates to provisions of the main contract, it is unclear to what extent the provisions of the main contract are intended to have been incorporated into the subcontract. The partial award on jurisdiction in case No. 6611 [1992] is interesting as, in that case, the subcontract incorporated by reference the dispute resolution clause contained in Clause 67 of the FIDIC Conditions, which was part of the main contract, and an issue arose as to the validity of this incorporation by reference.

The relevant subcontract referred to certain specific listed documents as being deemed to be part of the subcontract, including the "Conditions of Contract, Parts I and II ... of the Main Contract" which provided for the settlement of disputes by arbitration according to Clause 67 of the FIDIC Conditions, second edition.

The claimant, a subcontractor, claimed that such arbitration clause was validly incorporated by reference into the subcontract whereas the defendant, the main contractor, denied this. In upholding the incorporation by reference of the arbitration clause, the arbitral tribunal noted, among other things, that:

- (i) the defendant knew and accepted the arbitration clause as it was the defendant who in fact had drafted the subcontract (as is usual practice, the subcontract had been drafted by the main contractor),
- (ii) in any event, the defendant's reply (or answer) to the request for arbitration was itself effective to create a new arbitration agreement, where the defendant had not raised any objection to the proceedings in the reply (the request for arbitration and the reply fulfilled, with respect to their written form and signature, the requirements of both the applicable Swiss Statute on International Private Law as well as the New York Convention), and
- (iii) the fact that the claimant started the arbitration proceedings without having previously referred a dispute to the engineer did not prevent the claimant from taking the matter to arbitration as:
 - (a) there was no engineer appointed under the subcontract, and
 - (b) even if the engineer named under the main contract were deemed to act under the subcontract, that engineer has ceased to be in office for 10 years before the proceedings.

Consequently the arbitral tribunal upheld its jurisdiction on the basis of the arbitration clause.

A similar ruling was reached in case No. 7423, which also involved a subcontract incorporating by reference a main contract based on the FIDIC Conditions. In this case, the specific issue was whether the requirement in the FIDIC Conditions for the referral of disputes to the engineer before arbitration applied to disputes under the subcontract. The arbitral tribunal held, based on a provision of the subcontract that the subcontractor was required to comply with all the provisions of the main contract on the part of the contractor to

be complied with, insofar as they relate to the subcontract works and "are not repugnant to or inconsistent with" the express provisions of the subcontract, that the arbitration provisions of the main contract applied **except for the requirement for adjudication by the Engineer**. A similar conclusion had also been reached in an earlier award in case No. 6230 [1990].¹³

II - MULTI-PARTY ARBITRATION (Employer – Main contractor – Subcontractor)

Case No. 5898 [1989] was between a subcontractor (the claimant) and the main contractor (the defendant) and raised, among other things, the issue whether, under the arbitration clause in the relevant subcontract, the main contractor could cause an ICC arbitration begun by the subcontractor against the main contractor to be consolidated with an arbitration begun subsequently by the main contractor against the employer under the main construction contract.

The relevant arbitration clause in the subcontract, Clause 18, was closely modeled on the arbitration clause in the English Federation of Civil Engineering Contractors (FCEC) form of subcontract, which entered into effect in March 1973 and was intended for use with the ICE Conditions of Contract of June 1973. However, whereas the 1973 FCEC form of subcontract was prepared principally for use with the English ICE Conditions of Contract, in this case the main contract was modeled upon the FIDIC Conditions, second edition, and not the ICE Conditions.¹⁴

¹³ This is reported in the first series of extracts of awards relating to the FIDIC Conditions, published in the June 1991 issue (Vol. 2/No. 1) of this Bulletin.

¹⁴ The English FCEC form of subcontract was often used with main contracts based on the FIDIC Conditions until 1994 when FIDIC published its own standard form of subcontract for use with the FIDIC Conditions, fourth edition, see FIDIC's "Conditions of subcontract for Works of Civil Engineering Construction," first edition, 1994 and Seppala, "The New FIDIC International Civil Engineering subcontract," (1995) 12 *ICLR* 6 and in English and French in *RDAI/IBLJ* (Paris), No. 6, 1995, p. 659.

The relevant arbitration clause in the subcontract provided as follows:

"(1) If any dispute arises between the Contractor and the Subcontractor in connection with this Sub-Contract, it shall, subject to the provisions of this clause, be referred to arbitration and shall be finally settled under the Rules of Conciliation and Arbitration of the International Chamber of Commerce by one or more arbitrators appointed in accordance with the said Rules.

(2) If any dispute arises in connection with the Main Contract and the Contractor is of the opinion that such dispute touches or concerns the Sub-Contract Works, then provided that an arbitrator/s has not already been agreed or appointed in pursuance of the preceding sub-clause, the Contractor may by notice in writing to the Sub-Contractor require that any dispute under this Sub-Contract shall be referred to the arbitrator/s to whom the dispute under the Main Contract is referred and if such arbitrator/s (hereinafter called the joint arbitrator/s) be willing so to act, such dispute under this Sub-Contract shall be so referred. In such event the joint arbitrator/s may, subject to the consent of the Employer, give such direction for the determination of the two said disputes either concurrently or consecutively as he may think just and convenient and provided that the Sub-Contractor is allowed to act as a party to the dispute between the Employer and the Contractor, the joint arbitrator/s may in determining the dispute under this Sub-Contract take account of all material facts proved before him in the dispute under the Main Contract.

(3) If at any time before an arbitrator/s has been agreed or appointed in pursuance of sub-clause (1) of this clause any dispute arising in connection with the Main Contract is made the subject of proceedings in any court between the Employer and the Contractor and the Contractor is of the opinion that such dispute touches or concerns the Sub-Contract Works, he may by notice in writing to the Sub-Contractor abrogate the provisions of sub-clause (1) of this clause and thereafter no dispute under this Sub-Contract shall be referable to arbitration without further submission by the Contractor and Sub-Contractor."

The subcontractor had filed a request for arbitration against the main contractor under the ICC Rules, pursuant to sub-clause (1) of the above clause. Thereafter, the main contractor had advised the subcontractor that it considered that a dispute had arisen in connection with the main contract, which "touched or concerned the subcontract works" and that, consequently, pursuant to sub-clause (2) of the above clause, it would require that the dispute be referred to the arbitrators to whom the dispute under the main contract would be referred. In these circumstances, the main contractor claimed that the subcontractor had no right to proceed with an arbitration directly against the main contractor. Thereafter, the main contractor filed a request for arbitration against the employer under the main contract (ICC case No. 5948) and requested the ICC Court to join the arbitration under the subcontract (ICC case No. 5898) with the arbitration which the main contractor had commenced under the main contract.

However, the ICC Court refused to effect this consolidation stating (correctly) that the conditions of Article 18 of the Internal Rules were not met.¹⁵ Therefore the Court decided not to join the arbitration under the main contract (ICC case No. 5948) with the arbitration under the subcontract.

Accordingly, the arbitration under the subcontract continued. However, the main contractor maintained that the arbitral tribunal in the arbitration under the subcontract did not have jurisdiction in light of sub-clause (2) of the arbitration clause (quoted above) and the main contractor's request to the subcontractor that the arbitration under the subcontract be joined with the arbitration under the main contract.

This made it necessary for the tribunal in the arbitration under the subcontract to analyze the arbitration clause in the subcontract, Clause 18 (quoted above). According to the tribunal,

¹⁵ Article 18 of the relevant (1975) ICC Internal Rules (Article 13 of the (1988) ICC Internal Rules) provided as follows: "When a party presents a request for arbitration in connection with a legal relationship already submitted to arbitration proceedings by the same parties and pending before the [International] Court of Arbitration, the Court may decide to include that claim in the existing proceedings, subject to the provisions of Article 16 of the ICC Rules of Arbitration." In cases Nos. 5898 and 5948, neither the "legal relationship" (e.g., the relevant contract) nor the "parties" were the same. In the (1998) ICC Rules of Arbitration, this matter is dealt with in Article 4(6) of the Rules.

Clause 18(1) constitutes a broad ICC arbitration clause covering "any dispute" between the contractor and the subcontractor "in connection with this subcontract." According to the tribunal, Clause 18(2) contains an exception to the arbitration clause in Clause 18(1). Clause 18(2) provides that if the conditions contained therein are realized, then any dispute under the subcontract shall be referred to other ICC arbitrators, that is, "the arbitrators to whom the dispute under the main contract is referred."

The award contains an excellent analysis of Clause 18(2). According to the tribunal, Clause 18(2) contains six "conditions precedent" which must be satisfied in order that a dispute under the subcontract may be consolidated with a dispute under the main contract:

- (i) a dispute must have arisen under the main contract;
- (ii) the contractor must be of the opinion that the main contract dispute touches or concerns the sub-contract works;
- (iii) the main contract dispute must be one which is referred to arbitration;
- (iv) the contractor must have given written notice that any subcontract dispute shall be referred to arbitrators "to whom the dispute under the main contract is referred";
- (v) the written notice must have been given to the subcontractor before an arbitrator(s) has been agreed or appointed in pursuance of Clause 18(1);
- (vi) the main contract arbitrator(s) is willing to act in the subcontract dispute (in which case the arbitrator(s) would act as "joint arbitrator(s)").

The award contains useful comments on each of these conditions. With respect to the **first** condition, the tribunal noted that Clause 67 of the FIDIC Conditions, second edition, provides for a four-step procedure (as mentioned earlier) before a dispute of difference may be submitted to arbitration under that clause:

- (i) in order to constitute a dispute, a claim must have been made which has been rejected;

- (ii) the dispute or difference must be referred to the engineer for decision;
- (iii) the engineer must have decided the dispute, or failed to take a decision, within 90 days of the submission; and
- (iv) within 90 days of the engineer's decision, or the expiry of the 90-days period to act, the main contractor may require the dispute to be referred to ICC arbitration.

The tribunal noted that in a previous ICC arbitration case,¹⁶ an arbitral tribunal in an arbitration under a subcontract had determined, contrary to the request of the main contractor, that a dispute under an arbitration clause, which was identical to Clause 18 in the present case (ICC case No. 5898), should not be referred to arbitration by main contract arbitrators. The earlier tribunal had held that the condition precedent for the main contractor's notice under Clause 18(2) of the subcontract ("(i)f any dispute arises in connection with the main Contract") **required that each of the four steps listed above should have been accomplished.** The tribunal had reasoned:

"Otherwise, the normal method of resolving disputes under the contract by means of Clause 18(1) could easily be blocked by reference to a supposed dispute or dispute in respect of which there was no need or intention to seek arbitration."

In this connection, quite recently the English Court of Appeal in *M.J. Gleeson Group v. Wyatt of Snetterton*¹⁷ held that the word "dispute" in Clause 18(2) of a subsequent edition of the FCEC form (that is, subsequent to the one used in the subcontract in ICC case No. 5898) includes "any case where a claim had been put forward and rejected" and the contractor **was not required to have referred the dispute to the engineer under the main contract.** However, the wording of Clause 18(2) in that case was sufficiently different from the wording of Clause 18(2) in case No. 5898 to justify a different result.¹⁸

¹⁶ Case No. 5333, 4 *ICLR* 321, 327 (1987).

¹⁷ 72 *Building Law Reports* 15 (1994).

¹⁸ In the *M.J. Gleeson Group* case, Clause 18(2) (which was based on the 1987 edition of the FCEC form) had provided as follows: "If any dispute arises in connection with the Main Contract and the Contractor is of the opinion that such dispute

As we have seen above, the **second** condition precedent for consolidation is that the main contractor must be of the opinion that the main contract dispute "touches or concerns the subcontract works." The tribunal stated that this condition may in fact be divided into three sub-conditions:

"- The Contractor must express the opinion that the dispute under the Main Contract touches or concerns the Sub-Contract Works;

- This implies that the Contractor's opinion must be determined in good faith and that his exercise of the corresponding option under [the clause corresponding to sub-clause (ii)] is not abusive;

- The contractor's opinion, thus expressed in good faith, must be that the dispute under the Main Contract is not only related to the Sub-Contract but "touches or concerns the Sub-Contract works."

In other words, the dispute under the Main Contract must in some way touch or concern the manner in which the Sub-Contract Works were to be performed and were actually performed. [Emphasis added]

On the difficult (in the author's view) question of when a dispute "touches or concerns the subcontract works," the tribunal suggested that in the following cases the dispute would **not** "touch or concern the subcontract works":

"Where, for example, the Employer was not to deny liability but simply was unwilling or unable to pay (for instance in bankruptcy), the Contractor might be forced to take its payment dispute to arbitration to obtain an award subject to execution, but it would not be a dispute which touches or concerns

touches or concerns the Sub-Contract Works, then provided that an arbitrator has not already been agreed or appointed in pursuance of the preceding sub-clause, the Contractor may by notice in writing to the Sub-Contractor require that any such dispute under this Sub-Contract shall be dealt with jointly with the dispute under the Main Contract in accordance with the provisions of Clause 66 thereof. In connection with such joint dispute the Sub-Contractor shall be bound in like manner as the Contractor by any decision of the Engineer or any award by an arbitrator."

the Sub-Contract works. When the Defendant [the main contractor] first outlined the basis of its claim against the Employer by telex on February 24, 1987, the greatest number of those claims related to failure to make payments alleged to be due. Another claim related to an alleged contractual default caused by the Employer reletting the contract to the Claimant [the Sub-Contractor]. Neither type of claim would necessarily involve the Sub-Contract Works." [Emphasis added].

Accordingly, the tribunal concluded that it had "some doubts" as to whether, and to what extent, the main contract disputes in fact "touch or concern the subcontract works."

With respect to the **third** condition precedent that the main contract dispute must be one which is "referred" to arbitration, the tribunal held, not surprisingly, that this meant a request for arbitration must have been submitted to the ICC Court as, only on that date under the ICC Rules, were arbitral proceedings deemed to have commenced.

With respect to the **fourth** condition that the contractor must have given written notice that any subcontract dispute shall be referred to the arbitrators to whom the dispute under the main contract is referred, the tribunal held that it was necessary that the main contractor had at least commenced an arbitration under the main contract and nominated one arbitrator in order to satisfy that condition.

With respect to the **fifth** condition that written notice must have been given to the subcontractor before an arbitrator(s) has been agreed or appointed in the arbitration under the subcontract, the tribunal stated that (in the case of a three-person tribunal) the date to be retained is that of the confirmation by the ICC Court of the arbitrator nominated by the subcontractor. Accordingly, it was important that the written notice had been given before that date.

Finally, with respect to the **sixth** condition that the main contract arbitrators are willing to act in the subcontract dispute, the tribunal indicated that the main contractor must produce evidence to show that the tribunal in the arbitration under the main contract would be willing to accept to adjudicate the dispute under the subcontract.

In the case at issue (case No. 5898), the tribunal found that the conditions for consolidation of the dispute under the subcontract with the arbitration under the main contract had not been satisfied and, consequently, rejected the main contractor's plea that the tribunal was without jurisdiction to hear the dispute that had been referred to it by the subcontractor under the subcontract.

Together with the ICC award in case No. 5333, referred to above, the award in case No. 5898 is most illuminating about the use of Clause 18 of the FCEC subcontract form together with the FIDIC conditions and, on another plane, most instructive about the issues which need to be addressed when drafting a multi-party arbitration clause involving an employer, a main contractor and a subcontractor where the FIDIC Conditions are used.

III - "PAY WHEN PAID" CLAUSES IN SUBCONTRACTS

Case No. 6611 [1993] concerned a claim by a subcontractor under a subcontract for work done in a case where the subcontract, which contained a so-called "pay when paid" clause (that is, a clause providing that the subcontractor would be paid only when the contractor had been paid by the employer), had been terminated by the main contractor following abandonment of the project by the employer (who was not a party to the arbitration). The relevant subcontract was governed by Swiss law.

The tribunal considered two questions:

- (a) Did the claimant (subcontractor) have a conditional or unconditional claim against the defendant (a consortium of contractors constituting the main contractor) for the payment of the work performed by the claimant, i.e., was payment of the defendant by the employer a condition precedent or not to the right of the claimant to be paid by the defendant, and
- (b) Assuming the claim of the claimant was conditional, had the necessary condition been satisfied, that is, had the defendant been paid by the employer in respect of the work performed by the claimant?

The tribunal considered each of these two questions in turn.

A. Did the claimant have an unconditional claim against the defendant?

Under the "pay when paid" provision, the subcontractor (i.e., the claimant) would be paid "at the time and in the manner" that the main contractor (i.e., the defendant) received payment from the employer.

While, upon first impression (according to the tribunal), such a provision would appear merely to regulate the time for payment of the subcontractor rather than to make payment by the employer of the main contractor a condition precedent to payment of the subcontractor, on closer analysis (according to the tribunal) this proved not to be the case. According to the subcontract, the claimant was to "bear all obligations and risks" arising from the main contract "in such a way as if the subcontractor had concluded a direct contract with the employer for his scope of supply and services." Upon the basis of this provision, the tribunal concluded that the claimant had accepted not only the risk of delay in payment by the employer but also the risk of non-payment by the employer. Accordingly, the tribunal concluded that payment of the defendant by the employer was a condition precedent to the right of the claimant to be paid by the defendant.

On the other hand, the tribunal found that for payment of the main contractor to be a condition precedent "is generally speaking inconsistent with the concept of subcontract" as (according to the tribunal) a subcontract is regarded as a "full independent contract vis-à-vis the main contract" and there is no connection between the subcontractor and the employer. This led the tribunal to conclude that while the "pay when paid" clause in the subcontract was valid under Swiss law, it must be "very carefully interpreted, i.e. in a way compatible with the notion of subcontract."¹⁹ This point became important in relation to the tribunal's handling of the second issue.

¹⁹ While not subject to a great deal of reported litigation elsewhere, "pay when paid," "if and when" clauses and the like have been the subject of many court cases in the United States, where the use of such clauses is widespread. In most States (of the United States), the essential legal issue presented

B. Had the contractual condition been satisfied, that is, had the defendant been paid by the employer in respect of the work performed by the claimant?

It was undisputed that the defendant had received a 15% down payment under the main contract and had distributed approximately half of this to its partners (in the consortium constituting the main contractor) and subcontractors. Thus, each had received a 15% down payment under its contract. However, it was undisputed that the claimant had performed work far exceeding in value the down payment paid to it and the issue was whether the down payment received by the defendant from the employer should be considered, at least in part, as payment by the employer for the work performed by the claimant.

The defendant maintained that the down payment had been received before any work had been performed and that there was no legal or contractual basis to re-allocate this down payment *ex post facto* among the parties based on work performed or the damage a party claimed to have suffered.

However, the tribunal disagreed, stating that a down payment is merely a payment on account of work to be performed in future and that no contractor has an inherent right to keep the same.

by such clauses is (as was recognized by the tribunal in ICC case No. 6611[1993]) whether they establish a condition precedent to the contractor's obligation to pay the subcontractor or, instead, merely regulate the time for payment by the contractor of the subcontractor. The majority view (reflecting, the author suggests, a policy in many U.S. jurisdictions to protect subcontractors, as generally the weaker party) is that they regulate only the time for payment, see *Thomas J. Dyer Co. v. Bishop International Engineering Co.*, 303 F. 2d 655 (6th Cir. 1962) and subsequent cases following it. In a minority of States such clauses may be void and unenforceable by statute. Thus, in the State of New York, a clause providing that payment of the main contractor was a condition precedent to the right of the subcontractor to be paid was recently held by the New York Court of Appeals (New York's highest court) to violate New York's Mechanics Lien Law. *West-Fair Electrical contractors and L.J. Coppola, Inc. v. The Aetna Casualty & Surety Company and Gilblane Building Company* 87 N.Y. 2d 148, 661 NE 2d 967, 638 NYS 2d 394 (1995). See the commentary on that case in Rubin and Cruz "Contingent Payment Clauses Violate New York's Mechanics Lien Law," *ICLR* 1997, 245.

The tribunal noted that the employer had acknowledged certified works and supplies which included all of the work for which the claimant was seeking payment. Furthermore, the employer considered that all civil works carried out by the claimant had been paid for.

On the other hand, the defendant alleged that the tribunal ought to take account of the defendant's alleged loss and related claim against the employer. But the tribunal said that a "non-adjudicated" claim by the defendant against the employer was incapable of being held against the claimant. The tribunal concluded:

"... the Defendant has been paid – as soon as on June 15, 1988 (the date of contract termination) – by the Employer in respect of the work performed by the Claimant. Thus the payment condition was met on this date and the Defendant must accordingly pay the Claimant."

Thus, while the tribunal had found that the "pay when paid" clause had, in the context of this particular subcontract, made payment by the employer of the main contractor a condition precedent to the payment of the subcontract, the tribunal concluded that, on the facts, such condition precedent had been satisfied and the subcontractor, therefore, was entitled to be paid.

IV - TERMINATION OF THE CONTRACTOR FOR DEFAULT (Clause 63)

Case No. 5948 dealt with a number of interesting issues that arise in the case of the termination (or purported termination) by the employer of a contract based on the FIDIC Conditions in reliance upon a certificate (or purported certificate) of the engineer under Clause 63 of the FIDIC Conditions, second edition. The case concerned the construction by an American contractor of a hospital for the government of an Arab State. The engineer under the contract was an official of the Ministry of Public Works of the State concerned. The employer claimed to have validly terminated the construction contract pursuant to Clause 63 and the first issue to be considered by the tribunal was, therefore, whether the employer's termination of the contract based on that clause was valid.

As is well known, in order for the employer to be able to terminate a construction contract under one ground in Clause 63(1), the engineer must first have certified in writing to the employer that in his opinion the contractor was not executing the works in accordance with the contract. The first question therefore for the tribunal to consider was the effect in law of the engineer's letters and/or certificates issued under Clause 63(1) of the Conditions of Contract.

With respect to this issue, the tribunal stated that Clause 63 is a "forfeiture clause" and that "if it is to be relied upon, its machinery must be complied with strictly." The tribunal, then, continued as follows:

"There can be no entry and expulsion under that clause (and therefore no valid certificate under Clause 63(3)) [author's note: providing for the issuance of a payment certificate by the engineer certifying that a payment was required to be made either to the contractor or to the Employer] unless in the first instance the Engineer has certified in writing to the Defendant as far as is herein relevant that in his opinion the Contractor was not executing the Works in accordance with the Contract or was persistently or flagrantly neglecting to carry out his obligations. If, and only if, such certificate is addressed by the Engineer to the Defendant the latter may give 14 days written notice to the Contractor, enter upon the site, and expel the Contractor therefrom. The first question, therefore, is whether the Government can demonstrate that there was a valid certificate in writing by the Engineer under Clause 63(1). Without such a valid certificate the Defendant cannot invoke the machinery of Clause 63 (3), for it would not have entered upon the site and expelled the Contractor "under this Clause," and thus a condition precedent to the issuance of a certificate under Clause 63(3) would not have been fulfilled."

The tribunal held that the document relied upon by the defendant as a certificate of the engineer under Clause 63(1) was not a certificate satisfying the requirements of that Clause as:

- (i) it was not addressed to the defendant (the employer) but to the contractor, although a copy was sent to an official of the employer,

(ii) it was "debatable" whether it was a communication from the engineer or the Employer, and

(iii) the document did not in form "certify" anything at all. It did not use the word "certify".

While the tribunal acknowledged that these were "very technical objections," it emphasized that the Clause was a "forfeiture clause". In this light, the tribunal concluded that these objections were valid.

Having found that the employer had not complied with the procedure in Clause 63, the tribunal concluded that the engineer's letter or decision awarding a sum to the defendant pursuant to Clause 63(3) was invalid. Accordingly the tribunal found that nothing was due to the employer pursuant to that clause, and that the contractor had not been validly expelled from the site under Clause 63.

Nevertheless, the employer raised a further argument. Assuming the contractor had not been validly expelled from the site in accordance with Clause 63, had it (the employer argued) been lawfully expelled from the site "as an exercise of any right available to the employer under the contract and/or as a matter of general law"? While the tribunal acknowledged that:

"(n)othing in Clause 63 of the Contract provides that the Defendant's right to exercise the option conferred upon it by that Clause is to be the exclusive remedy..."

the tribunal concluded that the necessary pre-requisites under the applicable law for a valid rescission of the contract by the employer had not been established. Accordingly, the tribunal found the employer's termination of the contract to have been wrongful.

V - DAMAGES THAT ARE PAYABLE WHERE AN ADVANCE PAYMENT IS PAID LATE

In case No. 5948 [1993], an advance payment had been duly certified by the engineer and the contractor had promptly provided the employer

with an advance payment guarantee. However, the advance payment was paid with a delay of 202 days and, consequently, the contractor claimed damages for late payment of the amount involved.

The tribunal held that the contractor could recover its costs for this breach of contract on one of two bases:

- (i) the commercial value at the relevant time of the right to use for 202 days a sum of money equal to the advance payment. This would *prima facie* be measured by applying a fair commercial rate of interest over the period; or
- (ii) the consequential losses suffered by the contractor by reason of its inability to spend such sum 202 days earlier in furthering the contract works.

With respect to the second ground, the tribunal noted that the contractor should in principle be able to recover any net extra expenditures and liabilities incurred by it which:

- (i) were caused by the breach of contract (i.e., were rendered abortive by the lateness of the advance payment or would not have not been incurred at all but for that lateness); and
- (ii) were a reasonably foreseeable consequence of that breach.

With respect to what costs "were rendered abortive by the lateness of the advance payment" ((i) above), the tribunal stated as follows:

"The costs of [preparatory work] became abortive to the extent that the personnel in charge of the project is no longer in a position to achieve productive work, but cannot be dismissed or directed to other projects in view of the expectation that the works may actually continue at any time.

The period of the advance payment delay was ultimately of such length that most of the personnel and other time related costs became abortive.

In view of these considerations we find that a percentage of 20% of the allowable costs for home office overheads, staff salaries, medical

insurance, staff expenses, postage and DHL, air fares, sundry expenses, hotel accounts, visa fees, site electricity and telephone/telex was not abortive and 20% thereof should be deducted as the value of productive work."

With respect to the issue of foreseeability ((ii) above), the tribunal then stated as follows:

"We are satisfied that the Claimant was throughout largely dependent upon the prompt effectuation of Contract payment obligations by the Defendant to enable the work to be funded and proceed in accordance with the programme. We find that it was from the outset reasonably foreseeable, and in truth foreseen, by the Defendant that any failure on its part to make payments when legally due was quite likely to result in delay to the work, and in increased outlays by the Claimant arising from the consequent need to devote resources to their task over a lengthier duration and with impaired economic efficiency. There is no doubt that this is what, to an appreciable extent, occurred."

However, the tribunal then noted that it was for the claimant to establish with reasonable particularity the nature and extent of the losses it claimed to have suffered, and the tribunal then went on to consider the evidence which the claimant had produced on this issue.

VI - WHETHER THE FIDIC AND ENAA FORMS CONSTITUTE TRADE USAGES

Case No. 8873 [1997] dealt with the issue whether the principles contained in the FIDIC or ENAA (Engineering Advancement Association of Japan) forms of construction contract had become so widely accepted as to constitute veritable trade usages which might apply in the construction industry even to a case where the parties had not expressly agreed to adopt them. Unsurprisingly, the tribunal concluded that the principles in these forms of contract did not satisfy the requirements to become trade usages as:

- (i) the solutions provided by these forms of contract were not found to have been applied in practice with a sufficient degree of uniformity, and
- (ii) the party invoking this theory could not prove that the principles embodied in these forms were applied in the construction industry in the absence of an express of agreement of the parties.

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The texts of Messrs Briner, Kreindler, Seppala and Van den Berg were written in English while that of Mr Block was translated from the French original.

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