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LEGAL INSIGHT

LEGAL ALERT:
WATER AND SEWAGE AUTHORITY OF TRINIDAD & TOBAGO (RESPONDENT) VS WATER WORKS LTD TRINIDAD & TOBAGO (APPELLANT)

PRIVY COUNCIL CLARIFIES ON CLAUSE 19.6 (C) OF THE FIDIC GENERAL CONDITIONS OF CONTRACTS

KTA ADVOCATES

INTRODUCTION

The Board of the Privy Council recently clarified on clause 19.6(c) of the Yellow Book (1999) edition, holding that whilst the Contractor is expected to proceed with works on the assumption that the contract will be completed and without anticipating early termination, the Contractor entered into **"a bad bargain"** by committing **to pay 30% cancellation fees to the third party.** The case further expounds on the burden of proof required for the Contractor to succeed under clause 19.6 (c) of the FIDIC General Conditions of Contract specifically the Yellow Book, (1999) edition.

FACTUAL BACKGROUND

The Dispute was about the Federation Internationale des Ingenieus- Conseils (FIDIC) standard forms of Contract for **Plant and Design-Build For Electrical and Mechanical Plant, and For Building and Engineering Works, Designed by the Contractor, commonly known as the "Yellow Book" the (1999) edition,** which is intended for use in projects where the Contractor has the main responsibility for design as well as the construction of plant or equipment on site.

The Contractor, Water Works Ltd, and the Employer, Water and Sewage Authority of Trinidad and Tobago, executed two Design and Build contracts (1999) edition referred to as "The Matura Contract" and "The Yarra Contract" for planned Water Treatment Plants.

The Matura Contract was executed on 30th July 2007 and the Yarra Contract on 3rd October 2007. The Contract period was for 15 months and the date for commencement of the two works was 14 days after the contract was signed.

The general scope of the work had three phases and these included: preparation of preliminary designs, preparation of the final designs and drawings by Contractor and approval by the Employer and lastly, construction of the plants as per the drawings and plans.

By letters dated 24th June and 12th October 2009, the Employer terminated both contracts for convenience under clause 15.5 of the FIDIC General Conditions of Contracts.

However, at the time of tenders, the Contractor had engaged a Canadian Company called MAAK Technologies Group Inc. ("MAAK") to provide design and construction supervision services for each project.

On 14th and 25th March 2008, MAAK also provided quotations to the Contractor to supply equipment for use in building each plant. The quotations for Matura Water plant equipment and "Yarra Water Equipment" were at a total price of TT$15,396,761 and TT$ 11,926,474.88 respectively. All these two contracts were accepted by the Contractor by issuing purchaser orders.

These contracts had a unique clause which provided that if the buyer cancels the agreement, they must pay a cancellation fee ranging from 30% to 100% of the products' quoted price, depending on when the cancellation occurs. Additional costs incurred by MAAK related to the agreement may also be charged.

When the Employer terminated both the Matura and Yarra Contracts, the MAAKs contracts were cancelled too, which meant that the Contractor had to pay the cancellation fees of 30%. The Contractor submitted financial claims to the Engineer, and some were awarded but the cancellation charges were rejected hence the main subject of this dispute. These contracts will hereinafter be referred to as the MAAKs Contracts.

ISSUE IN CONTENTION

Whether the liabilities to pay the cancellation charges were "reasonably incurred by the Contractor in the expectation of completing the works" to fall within clause 19.6(c) of the FIDIC General Conditions of Contract.

DECISION OF THE TRIAL COURT.

The trial judge held that the liabilities were reasonably incurred by the Contractor in the expectation of completing the works as per clause 19.6(c) of the FIDIC General Conditions of Contract.

The judge held that it was reasonable for the Contractor to enter into MAAKs Contracts in the early stages of the projects to ensure that the cost of the equipment did not exceed the cost used as the basis for its tender.

DECISION OF THE COURT OF APPEAL

The **Authority appealed** the trial court's decision, and the **Court of Appeal effectively overturned** the trial court's ruling that was in favor of the Contractor regarding the cancellation charges on the following reasons; **premature financial commitments by the Contractor, inconsistency in interpreting the purchase orders by the trial judge and insufficiency of the preliminary designs to identify and order the specific equipment that was ordered by the Contractor.**

DECISION OF THE PRIVY COUNCIL

The Contractor appealed the Court of Appeal's decision to the Privy Council, which dismissed the appeal and upheld the Court of Appeal decision.

The Board ruled that the Contractor's liability to pay cancellation charges did not qualify as **"reasonably incurred under clause 19.6 (c)"** and was a bad bargain made by the Contractor.

ARGUMENTS ADVANCED BEFORE THE PRIVY COUNCIL

a) Contractor's Arguments

The Contractor argued that there was no proper basis for the Court of Appeal to overturn the trial judge's findings regarding the following:

- The nature of the MAAK contracts; and
- That the preliminary designs contained sufficient information to identify the equipment required to construct the water treatment plant.

The Contractor further argued that it was open to the trial judge to conclude that the Contractor acted reasonably in entering into the MAAK contracts with the purpose of maintaining the prices that were used at the tendering period.

Lastly, the Contractor argued that, considering the short duration of the project (15 months), the judge was entitled to find that the liabilities to pay cancellation charges to MAAK were reasonably incurred and therefore fell within Clause 19.6(c) of the FIDIC General Conditions of Contract.

b) Employer's Argument.

The Employer argued that a prudent Contractor would not generally commit itself to purchasing equipment before it is needed and before the designs to which the equipment conforms have been finalized and approved, which the Contractor in the instant facts did.

DECISION BY THE PRIVY COUNCIL.

The Privy Council held that it was prima facie unreasonable for the Contractor to undertake obligations to pay cancellation charges of 30% if the purchase orders were cancelled when MAAK was not, so far as the evidence shows, itself incurring any costs or liabilities for which those charges could be regarded as compensation.

The Board also clarified on the burden of proof when it held that the Contractor had the burden of proving that it incurred a cost or liability that fell within clause 19.6(c) of the FIDIC General Conditions of Contract, which the Contractor in the instant facts failed to prove by way of evidence. In the instant case, the Contractor could have discharged itself of this evidential burden by adducing evidence to explain how the decision to enter MAAKs contracts was arrived at, why MAAKs Contracts were considered of interest to the Contractor.

The Privy Council, however, rejected the Employer's argument that, because the contractor knew or ought to have known that the Employer was likely to exercise its right to terminate the contract early for "convenience", the Contractor acted unreasonably in ordering materials or equipment. The Board agreed with the Contractor that as a general rule under a contract such as the contracts in the instant facts, the Contractor is entitled to proceed and to incur costs and liabilities on the assumption that the contract will be performed.

WHAT DOES THIS MEAN TO THE CONSTRUCTION INDUSTRY?

a) This decision should act as a critical warning to the Contractors to be cautious while entering early contractual obligations, costs or liabilities with third parties with anticipation that these would be recovered under clause 19.6(c) of the FIDIC Conditions of Contract. In essence, Contractors **should first consider why it is important to incur such liabilities or costs, why it is of interest for them to enter the Contract and whether there are other better alternatives that can be undertaken to achieve the same objective considering the stage of the project.**

b). The Board's decision should also serve as a clear caution to Employers operating under the FIDIC General Conditions of Contract (1999) edition: a Contractor is entitled to proceed and incur costs and liabilities on the reasonable assumption that the Contract will be performed to completion. This principle is reinforced by Clauses 8.1 and 8.2 of the FIDIC General Conditions, which obligate the Contractor to commence and execute the Works with due expedition and without delay.

To withhold or delay performance based on an anticipation that the Employer may terminate the Contract under Clause 15.5 would be inconsistent with the Contractor's obligations under Clauses 8.1 and 8.2. Such a course of action would expose the Contractor to the risk of liquidated damages and additional costs if early termination does not occur—costs for which the Contractor would not be entitled to compensation from the Employer.

CONCLUSION.

While this decision is persuasive, it should serve as a guide for Contractors and Employers still operating under the FIDIC General Conditions of Contract (1999) edition. However, the outcome may be different under the 2017 edition since it provides for payment for the Contractor for any loss of profits or other losses and damages suffered by the Contractor as a result of the Employer's termination for convenience. It is also important to seek legal advice from an experienced construction law attorney to determine the most appropriate contract to enter into, especially given that the FIDIC General Conditions of Contract have been updated. The updated editions aim to address and prevent issues that were encountered in previous editions. As I have pointed out, if this dispute had arisen under the 2017 edition, the decision should have been different.

DISLCLAIMER

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For specific guidance regarding Construction law matters, we strongly encourage you to contact an experienced construction law attorney.

Please feel free to reach out to KTA Advocates at corporate@ktaadvocates.com to discuss your specific needs.

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