

MASONS THELEN REID LLP

OCAI Construction Seminar

MANAGING PAYMENT DELAYS ON INTERNATIONAL CONSTRUCTION PROJECTS



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The Dynamics of Payment

- As a construction project moves toward completion, the Contractor loses leverage, and the Employer gains leverage.
- This is based on the reality that the contractor builds the project, and the Employer simply pays money.
- As the project nears completion, the Contractor has less leverage because the Employer is close to obtaining what he bargained for – a completed project.
- This is the time when the Employer will be inclined to suspend or reduce payments to the Contractor, not early in the Project.



The Wrong Response to Non-Payment

- The natural inclination of the Contractor who is near to completion is to continue working, regardless of the non-payment, and complete the project.
- This is absolutely the wrong step for the Contractor to take.
- With the project complete the Contractor has lost all commercial leverage – the Employer has what he needs.
- The unpaid Contractor **MUST** give notice of intent to take action in the event of non-payment.



Standard Contract Language Regarding The Contractor's Rights for Non-Payment

- Many standard contract forms in use in Asia do NOT give the Contractor any rights in the event of non-payment, other than the (inadequate) right to collect simple interest on the unpaid sums.
- But all of the standard contract forms give the Employer the right, for example, to suspend work for cause or for convenience.
- The Contractor MUST include language in every prime contract that protects the Contractor in the event of non-payment. This is so even in jurisdictions where there is a statutory right to suspend work for non-payment.
- A contract that allows the Employer to suspend work for no reason, but does not allow the Contractor to suspend work for non-payment, is a patently unfair contract.



The Law Where There Is No Express Right to Suspend Work for Non-Payment

- Without the express right in the Contract to suspend work or terminate the Contract, in the event of non-payment, the issue is whether the non-payment constituted a material breach of contract.
- Although the law varies from country to country, in general it is fair to say that the issue of when non-payment becomes a material breach of contract, justifying suspension or termination, is a grey area.
- Depending on the payment terms of the Contract, this can leave the Contractor exposed for the value of 4 – 5 months of work.



Payment Clauses from FIDIC Red Book, 4th Edition

- Monthly Statements 60.1

The Contractor shall submit to the Engineer after the end of each month six copies, ... of a statement, ... showing the amounts to which the Contractor considers himself to be entitled up to the end of the month ...

- Monthly Payments 60.2

The Engineer shall, within 28 days of receiving such statement, certify to the Employer the amount of payment to the Contractor which he considers due and payable in respect thereof ...

- Time for Payment 60.10

The amount due to the Contractor under any interim certificate issued by the Engineer pursuant to this Clause, ... shall, subject to Clause 47, be paid by the Employer to the Contractor within 28 days after such interim certificate has been delivered to the Employer ...

Termination and Suspension of Work

Clauses from FIDIC Red Book, 4th Edition

Default of Employer 69.1 In the event of the Employer:

- (a) failing to pay to the Contractor the amount due under any certificate of the Engineer within 28 days after the expiry of the time stated in Sub-Clause 60.10 within which payment is to be made, subject to any deduction that the Employer is entitled to make under the Contract; ...

the Contractor shall be entitled to terminate his employment under the Contract by giving notice to the Employer, with a copy to the Engineer. Such termination shall take effect 14 days after the giving of the notice.

Contractor's Entitlement to Suspend Work

69.4 Without prejudice to the Contractor's entitlement to interest under Sub-Clause 60.10 and to terminate under Sub-Clause 69.1, **the Contractor may**, if the Employer fails to pay the Contractor the amount due under any certificate of the Engineer within 28 days after the expiry of the time stated in Sub-Clause 60.10 within which payment is to be made, subject to any deduction that the Employer is entitled to make under the Contract, **after giving 28 days' prior notice to the Employer**, with a copy to the Engineer, **suspend work** or reduce the rate of work.



Illustration of FIDIC

Red Book Payment Delay

Month 1	Month 2	Month 3	Month 4	Month 5
Work is performed	Work is performed	Work is performed	Work is performed	Work is performed
	Contractor Submits Payment Application for Month 1	Contractor Submits Payment Application for Month 2	Contractor Submits Payment Application for Month 3	Contractor Submits Payment Application for Month 4
	Certificate issued for Month 1 (28 days after submission)	Certificate issued for Month 2	Certificate issued for Month 3	Certificate issued for Month 4
		Payment due for Month 1 (28 days after Certificate)	Payment due for Month 2 (28 days after Certificate)	Payment due for Month 3 (28 days after Certificate)
			Notice of intent to suspend work (28 days after non-payment)	Work is suspended at the beginning of Month 5

Managing the FIDIC Red Book Payment Delay

- We see that even where the Contract does give the Contractor the right to suspend work for non-payment, the Contractor can still be exposed to working four months without receiving any payment, until the Contractor can give notice of the intent to suspend work.
- And if the Contractor is not paid the first progress payment at the end of month 3, and does not promptly give notice of its intent to suspend work, the Contractor will quickly find that 5 months of work has been performed without receiving payment.
- This underscores the importance of giving notice of the intent to suspend promptly upon the expiration of the payment due date.



Three Suggestions for Managing Payment Delays

1. In negotiating the payment terms of the contract, for example, reduce the two 28 day periods to 14 days apiece. This is commercially reasonable, and will reduce the time delay for payment by at least one month.
2. Include in the Contract a suspension of work clause with a short notice period, 14 instead of 28 days, saving another ½ month.
3. Include in the Contract the right to suspend work in the event of the Employer's failure to provide evidence of its ability to finance the balance of the work.



Modifications to Payment Terms of FIDIC Red Book, 4th Edition

Monthly Payments

60.2

The Engineer shall, **within 14 days** of receiving such statement, certify to the Employer the amount of payment to the Contractor which he considers due and payable in respect thereof, subject:

Time for Payment

60.10

The amount due to the Contractor under any interim certificate issued by the Engineer pursuant to this Clause, ... shall, subject to Clause 47, be paid by the Employer to the Contractor **within 14 days** after such interim certificate as been delivered to the Employer

...



Modification to FIDIC Redbook, 4th Edition

Default of Employer 69.1 In the event of the Employer:

- (a) Failing to pay to the Contractor the amount due under any certificate of the Engineer **within 14 days** after the expiry of the time stated in Sub-Clause 60.10 within which payment is to be made ...

- (e) **Failing to provide reasonable written evidence to the Contractor of the Employer's ability to finance the remaining outstanding unpaid Contract Amount within 14 days after written request therefore.**

the Contractor shall be entitled to terminate his employment under the Contract by giving notice to the Employer, with a copy to the Engineer. Such termination shall take effect 14 days after the giving of the notice.



Modification to FIDIC Redbook, 4th Edition

Continued

Contractor's

Entitlement to

Suspend Work 69.4

Without prejudice to the Contractor's entitlement to ... terminate under Sub-Clause 69.1, the Contractor may, if the Employer fails to pay the Contractor the amount due under any certificate of the Engineer within 14 days after the expiry of the time stated in Sub-Clause 60.10 within which payment is to be made, ... **after giving 14 days prior notice** to the Employer, with a copy to the Engineer, suspend work or reduce the rate of work.



Illustration of Modified FIDIC Red Book Payment Delay

Month 1	Month 2	Month 3
Work is performed	Work is performed	Work is performed
	Contractor Submits Payment Application for Month 1	Contractor Submits Payment Application for Month 2
	Certificate issued for Month 1 (14 days after submission)	Certificate issued for Month 2
	Payment due for Month 1 (14 days after Certificate)	Payment due for Month 2 (14 days after Certificate)
		Notice of intent to suspend work (14 days after non-payment)
		Work is suspended in the middle of month 3 (instead of at beginning of month 5)



Suspension or Termination In Response to Non-Payment

- The FIDIC Red Book gives the Contractor the right to terminate the contract or suspend or reduce the rate of work in the event of non-payment.
- The choice of which path to take is a critical one.
- Generally, reducing the rate of, or suspending, the work will be the preferred alternatives, as they are the less drastic remedies.
- But there may be cases where the non-payment provides an opportunity for the Contractor to escape from an unprofitable contract by terminating the contract.



Reducing the Rate of Work

In Response to Non-payment

- As noted above, FIDIC gives the Contractor the option of reducing the rate of work in response to non-payment.
- This must be considered as a first option. It shows the Employer that the Contractor is serious about taking action in response to the non-payment.
- While reducing the rate of work does cause the negative cash flow to continue (although at a reduced rate), suspending work also has financial consequences (de-mobilization and, re-mobilization costs), assuming that the Contractor re-commences work, as will usually be the case.
- Slowing down the work as an initial response to non-payment, followed by a suspension and, ultimately, termination if necessary is a reasonable sequence of actions to take in response to non-payment.



Notice

- The key to suspending or reducing the rate of work for non-payment is providing notice of the intent to reduce or suspend.
- FIDIC Clauses 69.1 and 69.4 require advance notice of the intent to reduce the rate of or suspend work.
- The purpose of this advance notice is to give the Employer an opportunity to cure the breach of contract by issuing payment to the Contractor.
- In the notice, the Contractor should advise that it reserves the right to reduce the rate of work, suspend the work or terminate the Contract, citing the relevant provisions of the Contract.



Notice, Continued

- Extreme care must be taken to ensure that the notice strictly conforms to the terms of the Contract, as the notice document will be a key document in any subsequent litigation.
- Frequently the notice works, and the Employer pays the Contractor.
- So giving notice does NOT mean that the Contractor will need to suspend or terminate the Contract. It simply gives the Contractor that right.
- It is recommended that legal advice be obtained prior to suspending or reducing the rate of the work or terminating a Contract for non-payment.



Different Non-Payment Scenarios

- The term “non-payment” or phrase “failure of payment” can mean many different things on a construction project.
- Non-payment scenarios include:
 - Lack of Payment by the Employer after Certification
 - Reduced Payment after Certification
 - Non-payment of change orders
- Each of these scenarios presents substantially different challenges.

Non-payment After Certification

- This is the purest form of non-payment, and the strongest basis for suspending work or terminating the contract.
- Under this scenario, payment is certified but not issued.
- Although this scenario is rare, it does occur.
- This scenario presents the most serious and compelling case for the Contractor to suspend work, as it suggests that the Employer may be having severe financial difficulties.
- An Employer with severe financial difficulties is an Employer for which an unpaid Contractor should not work even 1 extra day.



Reduced Payment After Certification

- The reduced payment scenario is far more common than non-payment.
- This scenario creates much greater risks for the Contractor who is considering suspending work.
- The basis for the reduced payment may be a legitimate difference of opinion as to the percentage of completion or the validity of some Employer back charges.
- If the Contractor guesses wrong, and suspends work for non-payment, and a court later finds that the reduction was justified, the suspension of work may justify the Employer in terminating the suspending Contractor, which can have dire financial results.
- The reduced payment scenario, particularly late in the Project, may suggest that the Employer is attempting to generate a large pot of “disputed” money to leverage a favorable settlement with the Contractor after completion of the Project.



Non-payment of Change Orders

- The scenario where the Employer does not process and issue payment for a substantial amount of change orders is, unfortunately, very common to the international Contractor.
- It will be a rare case where counsel will advise the Contractor to suspend work based on non-payment of change orders.
- None of the standard forms of contract in use in Asia give the Contractor the right to suspend work or terminate based on non-payment of change orders.
- Indeed, most standard forms of contract state that in the event of a dispute over whether an instruction from the Engineer is in fact a change order, the Contractor will perform the work and pursue a claim for the change order, and will NOT suspend work.



The Importance of Being Able to Request Evidence of Financing

- Earlier, we discussed including a provision in the main contract that allowed the Contractor to request evidence of the Employer's ability to finance the balance of the costs of the work.
- Such a clause provides an important alternative to the Contractor.
- Recall that we also discussed the difficulty of suspending work where the Employer is REDUCING the amount of progress payments.
- These reductions may be made because the project is in financial difficulty.
- Being able to ask for evidence of the ability to finance the costs of the work, and then being able to suspend work if such evidence is not provided, provides the Contractor whose payment applications are being reduced with a good alternate basis for suspending work.

Summary

We have seen how to:

- (1) Reduce the time lag to receive payment;
- (2) Ensure that the Contractor has the right to reduce the rate of work for non-payment;
- (3) Ensure that the Contractor has the right to suspend work or terminate the contract for non-payment;
- (4) Ensure that the Contractor has the right to suspend work or terminate the contract if the Employer does not provide evidence of the ability to finance the costs of the balance of the work;
- (5) How to leverage an Employer into issuing payments for change orders by refusing to perform additional change order work;
- (6) How to manage different non-payment scenarios, and the order in which to use the different options that are available to the Contractor.

These are excellent tools to protect the Contractor who is not being timely and properly paid.

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