

NEW 2017 FIDIC SILVER BOOK – A STEP AWAY FROM PROJECT FINANCE NORMS?

INTRODUCTION

In this briefing, we analyse the changes introduced by the recently published FIDIC Silver Book (Second Edition 2017) ("**Silver Book 2017**") in the context of international project finance ("**PF**"), focussing on provisions which (i) do not reflect typical international PF requirements, or (ii) might have been included in order to align with recent market trends and technological advances.

FIDIC'S EDITORIAL APPROACH

Silver Book 2017 is stated to maintain the risk sharing principles of FIDIC Silver Book (First Edition 1999) ("**Silver Book 1999**"). It has, however, expanded significantly in length and complexity. This is doubtless, in part, a consequence of the drafting process. Silver Book 1999 was the product of a three-tier system involving (i) oversight by the FIDIC Contracts Committee, (ii) primary drafting by the Update Task Group and (iii) consultation with a review group.

Silver Book 2017, however, has been subject to a substantially more elaborate process involving (i) the FIDIC Contracts Committee, (ii) designated "Liaisons" and "Special Advisers", (iii) the FIDIC Contracts Committee Updates Special Group, (iv) the Initial Update Task Group, (v) the Second Stage Update Task Group, (vi) a BIM advisory team and (vii) a review group.

The result is a document which has more than doubled in length to 118 pages of General Conditions and DAAB rules, plus 68 pages of guidance, compared with the more efficient 60 pages (plus 30 pages of guidance) achieved by the Silver Book 1999. A number of the changes appear to have been carried over as a matter of course from the parallel amendments to the FIDIC Yellow and Red Books, when perhaps a more limited selection would have been appropriate for transposition in light of typical PF requirements.

The additional length brings with it additional process and complexity. It is highly questionable whether the benefits obtained from the changes introduced justify this and concerns have already been voiced that this will affect its adoption.

Key issues

- Silver Book 2017 is aimed at the PF market
- It is over twice the length of its predecessor which brings additional process and complexity
- There are still a number of areas where it does not reflect typical international PF requirements
- The new claims process is a potential headache and expense for Employers
- It is not tailored for use on renewable energy projects
- Risk allocation is more favourable to contractors in a number of areas by comparison to Silver Book 1999
- Any PF focussed amendment process will now necessarily be more labour intensive due to Silver Book 2017's additional length and complexity

GOLDEN PRINCIPLES

Where Silver Book 1999 was perhaps more measured in its acknowledgement that it "*may be suitable*" for various stated applications, but that it "*may require some negotiation*", Silver Book 2017 "*strongly recommends*" adherence to five "*Golden Principles*", each of which stipulates requirements which "*must*" be met by any Silver Book 2017 based contract.

One of the Golden Principles is a requirement that "*the duties, rights, obligations, roles and responsibilities of all the Contract Participants must be generally as implied in the General Conditions, and appropriate to the requirements of the project*", while another requires that "*[the] Particular Conditions must not change the balance of risk/reward allocation provided for in the General Conditions*".

There appears to be some inherent tension here. Some substantive amendments are typically required to any template to tailor it to the specifics of a particular project and local law (and the Guidance Notes acknowledge this). Silver Book 2017 has, however, arguably changed the overall balance of risk and reward in Silver Book 1999 in favour of the Contractor, with measurable consequences in terms of retained Employer risk/cost and bankability. If it is to succeed in its stated mission of being suitable for use in the PF market, we think considerable amendment will be required.

PROJECT FINANCING

As mentioned above, Silver Book 2017 is stated to maintain the risk sharing principles of Silver Book 1999, which in turn were intended to reflect the increased use of PF and the requirements of PF lenders. However:

- The General Conditions still make no provision for various commonly encountered mechanical requirements of PF lenders, e.g. assignment rights, direct agreements, ESAP compliance and attendance and inspection rights for the lenders' technical adviser.
- Some of the new provisions (e.g. in respect of caps, waivers and performance security) remain substantively inconsistent with typical PF requirements. We comment on these in more detail below.
- While the Guidance Notes refer to some possible lender requirements and associated amendments, these are misaligned with typical PF market practice. For example:
 - Reference is made to ECA eligible content requirements, but remedies for non-compliance are not mentioned, leaving recovery of the Employer's resulting economic losses vulnerable to exclusion.
 - It is claimed that lenders may "require restrictions" on the right of rejection. Lenders will normally require any rejection right to be well considered in its scope and consequences, but restricting it as such is generally not their objective.
 - It is asserted that lenders may require that the Contractor be given the right to suspend/terminate in the event of default under the financing arrangements. In our experience, lenders are typically more focused on ensuring that any such rights are appropriately limited and subject to lenders' rights under the direct agreement.
 - The Guidance Notes suggest that lenders may require the Employer to make payments from its own resources in the case of external financing

shortfalls, implying that such a requirement may appear in the Contract. In a typical PF structure, the Employer makes available no resources beyond initial capital contributions and specified contingencies. Any standby payment requirements are imposed on sponsors (not the Employer) and will be regulated entirely by the financing documents and not articulated in the Contract.

Caps and Waivers (Clause 1.14)

In the majority of jurisdictions, the basic scope of the FIDIC 'economic loss' waiver (i.e. defined heads of direct or indirect economic loss plus generic "indirect and consequential loss") is inherently unfavourable to the Employer, even though the waiver is nominally reciprocal, based on the underlying nature of its likely claims (for example, it can create a potential issue around liability for the costs of repairing consequential physical damage or for intellectual property claims). In addition, the meaning under common law of the terms "indirect" and "consequential" loss has become less predictable as a result of recent court decisions such as *Polaris*¹ and *Transocean Drilling*². It is therefore common in the market to negotiate a comprehensive definition of excluded loss in place of reliance on those generic terms.

Despite a number of helpful new carve-outs from the waiver having been included in Silver Book 2017 (e.g. liability for general delay liquidated damages), PF lenders are still likely to require additions to the list (e.g. liability for breach of law/consent, certain indemnities and delay damages payable as a result of termination).

The list of exclusions from the overall liability cap also remains narrow by PF market standards, e.g. there is no mention of the cost of executing the works, fines and penalties due to breach of law or vitiation indemnities.

Performance Security (Clause 4.2)

A number of common PF lender issues with Silver Book 1999 performance security provisions remain. By way of example:

- the list of permitted grounds for calling the bonds raises an enhanced risk of challenge/injunction from contractors on the basis that a listed ground has not arisen; and
- there is no protection against bond issuer credit downgrades or provision for minimum stipulated credit ratings for bond providers.

The Guidance Notes and specimen forms of bond raise further potential issues, which are at variance with common PF market practice. By way of example:

- the Guidance Notes suggest that a bond issuer domiciled in the country where the project is located is acceptable in all cases. This may simply not be the case as ease of enforcement may vary; and
- one of the sample bond forms refers to the frequently-used option of reducing the face value of the performance bond at or around the time of taking over the works. While the *Beckton*³ case offers some protection under English law, there may be concerns under other governing laws that the now more time consuming claims procedures (under clauses 3.5 and

¹ Star Polaris LLC v HHIC-Phil Inc [2016] EWHC 2941 (Comm)

² Transocean Drilling UK Ltd v Providence Resources Plc [2016] EWCA Civ 372

³ J Murphy and Sons Ltd v Beckton Energy Ltd [2016] EWHC 607 (TCC)

20) could reduce the possibility of successful bond claims being made before this reduction takes effect, especially in the case of Contractor liabilities which arise shortly before taking over, for example delay and, often, performance liquidated damages.

Further considerations for PF

Various further changes have also been built into Silver Book 2017 which do not tally with typical PF requirements. These include:

- Subcontractors (Clause 4.4) – as with the earlier edition, there are no provisions for the Employer to approve subcontractors. Perhaps of greater note, the definition of Subcontractor now stops after tier 1 subcontractors and thereby undermines the principle of the Contractor fully wrapping its supply chain.
- Notification of delay by the Employer (Clause 8.5) – a new clause preserves the position realised in *Obrascon*⁴ in unwantedly (for the Employer) prolonging the period during which the Contractor must bring claims before it is time barred.
- Milestone Payments – the Guidance Notes discourage the use of milestone payment regimes, despite these being the preference of PF lenders.
- Employer set-off (Clause 14.6.1) – the Employer appears to have lost its express entitlement to set-off any payment rights in its favour which accrue between issue of the Employer's payment notice and the due date for the relevant payment.
- Contractor termination (Clause 16.2) – Silver Book 1999 already contained a list of Contractor termination rights which was typically narrowed on PF projects. That list has now been expanded to include e.g. a failure to comply with Claim determinations, although a number of the new termination rights (e.g. for the Employer's corrupt practices) seem objectively justifiable.
- Employer Risks (Clause 17.2) – the Employer retains the risk for a number of new events, some of which seem commercially or conceptually questionable on the basis that the 'Employer's risks' typically comprise only those for which CAR cover is not available. These new events include loss or damage caused by:
 - defects in the Employer's design of the Works, which is inconsistent with a turnkey contract;
 - an unforeseeable operation of the forces of nature. Given resulting damage is generally insurable, it is unclear why the Contractor should be released from its duty to reinstate;
 - strikes and lockouts. Again such damage should be insurable; and
 - natural catastrophes. This both overlaps with the new "forces of nature" item and should be at least partly insurable.

It is a notable shift that any instructed reinstatement is now payable as if the work were a Variation (i.e. with the Contractor receiving its margin), whereas Silver Book 1999 confined compensation to 'Cost' only, consistent with the 'no fault' nature of most of the listed risks.

⁴ *Obrascon Huarte Lain SA v Attorney General for Gibraltar* [2014] EWHC 1028 (TCC)

- Contractor Indemnities (Clause 17.4) – the Silver Book 1999 indemnities expressly covered claims arising out of the Works and "the remedying of any defects". The coverage for defects has now been deleted. A further condition has been imposed on the property damage indemnity that the damage must be attributable to Contractor default/breach/negligence. This both dilutes the indemnity and reverses the burden of proof compared to Silver Book 1999. Both changes are arguably inconsistent with a turnkey approach and the stated mission to facilitate the use of PF.
- Shared Indemnities (Clause 17.6) – this new provision reduces the Contractor's indemnity liabilities in respect of death, injury, damage to property and IPR infringement proportionately to any contribution to those outcomes caused by the Employer's retained risks. It is difficult to understand the perceived interaction between the IPR indemnity and the Employer's retained risks.
- Exceptional Events (Clause 18) – exceptional event relief is now more easily triggered due to the fact that there is no pre-requirement for an underlying event actually to be "exceptional". Further it is not always clear how the exceptional event regime is intended to interact with the new Claims procedure in Clause 20.
- Insurance (Clause 19) – the Contractor is required to take out key insurances, including CAR. PF lenders typically require the Employer to take out CAR cover, as it can facilitate their ability to take security, as well as increasing access to DSU/ALOP cover for the project.

CLAIMS AND DISPUTES

Perhaps the most striking change in Silver Book 2017 is the restructuring of the processes for processing "Claims" and "Disputes" (in Clauses 20 and 21 respectively) which are now subject to separate definitions and regimes.

The claims process is intended to apply equally to Claims by either the Employer or the Contractor, including in respect of time bars for bringing claims, although the Contractor (but not the Employer) still benefits from the *Obrascon* loophole referred to in respect of Clause 8.5 above. In a PF context, the difference between the resources and functions of a typical "thin" SPV Employer and a typical turnkey Contractor would arguably have justified retaining an asymmetrical approach, especially in respect of time bars.

The operation of the Silver Book 1999 mechanism for determining Employer claims has been improved by the addition of specific time limits and the clarification of the interim binding effect of any determination. However, the drafting which seeks to achieve this is elaborate and runs to a number of pages. The time limits for reaching Clause 3.5 determinations also seem lengthy given their purpose, especially when viewed in conjunction with the extended duration of the DAAB procedure and when compared to the shorter adjudication etc. periods applied with success under other contractual and statutory regimes.

All formal disputes must now be referred to a Dispute Avoidance/Adjudication Board (or a Dispute Adjudication Board, if applicable) for a provisionally binding decision as a condition precedent to arbitration. While admirable in its intention (best dispute resolution practice clearly involves both avoidance and effective fast track mechanisms), a mandatory standing disputes board may add unwanted expense to projects where tariff competition, and thus the need to minimise capex, is fierce. Similarly, the need for flow-down from higher tier

project documents and/or the potential unenforceability of DAAB decisions in certain jurisdictions may make subscription to the DAAB regime inappropriate.

SOME MISSED OPPORTUNITIES?

Silver Book 2017 does not cater expressly for a number of the changes in market trends and technological advances achieved in the period since Silver Book 1999's release. This is a pity, particularly with the current prevalence of renewables projects globally. We have listed some of these changes below.

Renewables

Renewables projects (particularly in those quasi-commoditised sectors where technology is proven and construction risk is relatively limited, such as PV solar and onshore wind) form one of the largest and fastest growing segments of the EPC turnkey market at which Silver Book 2017 is aimed – although as these sectors become increasingly 'safe', we are already seeing developers seeking to improve returns by moving away from a turnkey model.

Despite the upsurge in renewable power projects around the world, Silver Book 2017 remains more suited to the conventional power market. Perhaps the key example of this is the 'Tests after Completion' mechanism in clause 12, which remains light. This is symptomatic of the proposition in the Guidance Notes that any requirement for such tests is "exceptional". While that may be true of a number of markets, including conventional power plants, it is standard practice in renewables contracts for the critical performance tests (e.g. the 12-24 month output tests on solar plants) to be carried out after the works have been constructed and taken over. Silver Book 2017 would need substantial structural enhancement to function properly as a turnkey contract on a PF renewable power project as a result.

Building Information Modelling

FIDIC have chosen not to include any changes or provide any optional clauses in Silver Book 2017 dealing with the use of BIM. This is perhaps unsurprising given that the net of FIDIC contract usage is cast considerably wider than the pool of projects on which BIM is used globally.

The Guidance Notes refer to separate "Technology Guidelines" and a "Definition of Scope Guideline Specific to BIM" being published at some future point. It is clear, however, that the future incorporation of any such Technology Guidelines and/or Definition of Scope Guideline into a contract is unlikely of itself to be enough to adapt the Silver Book 2017 for successful use on BIM-enabled projects and amendments are likely to be required, for example to:

- the IPR licensing arrangements, particularly where ownership of the any federated model (and inputs into it) is to transfer outright between those providing inputs and the project owner;
- conflicts/priority clauses dealing with clashes between contract documents (including any BIM-related documents);
- the fitness for purpose and other design warranties; and
- the Contractor's general indemnities (including by catering for the potential impact of the scope of the Employer's own BIM inputs, and/or breaches of the Employer's/its BIM manager's other BIM obligations on the new 'Shared Indemnities' language in Clause 17.6).

Retention

Silver Book 2017 persists with the use of cash retention in lieu of bonding. This seems regressive compared to PF market practice, which rightly focusses on maintaining optimal project cashflows, to the ultimate benefit of developers, lenders and contractors alike.

FITNESS FOR PURPOSE

It has been well advertised that FIDIC has bolstered its fitness for purpose language with a new indemnity (Clause 17.4) which obliges the Contractor to indemnify the Employer in the event that the works are not fit for their intended purposes.

This is a puzzling introduction – the direct language seems likely to provoke adverse reactions from Contractors. Employers and PF lenders/financiers have usually found other solutions to express fitness for purpose language, particularly on plant projects with defined performance standards (which are now helpfully introduced into the FIDIC standard terms).

CONCLUSION

On balance, Silver Book 2017 perhaps offers a silver, rather than a gold, standard starting point for PF projects, where significant amendment is likely to be required not only to cater for project specifics, but also to align more closely with the PF norms it purports to accommodate. Its increased length and complexity have arguably made it less user-friendly and less consistent with those norms and also more cumbersome to adapt to align with them. Consequently, we predict that uptake of Silver Book 2017 might, initially at least, be slow as parties stick to tried and tested FIDIC based (or other) alternatives.

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