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**A 'sunburnt'
country:
international
contractors on
Australian projects**

**The case for
two-sided
certainty in
construction
contracts**

**Common law-style
contracts in a civil
law world**



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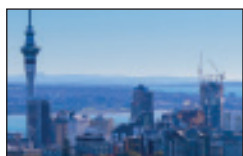
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Edited by Donald Charrett

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Cover image: Aerial view of the Sydney Harbour Bridge and CBD skyline at sunrise, from Lavender Bay. The new Crown Sydney tower can be seen under construction.
Credit: Taras Vyshnya/Shutterstock

FROM THE EDITORS

Dear readers,

This edition provides a truly global perspective on construction law issues. We continue our FIDIC Around the World series with an article looking at Italy, from which Arianna Perotti provides her insights.

We have country updates from Italy, Panama and Ukraine. Luis H Moreno IV provides an update on public-private partnership law in Panama, where a new regime has been established to regulate the institutional framework and development of investments. Anastasiya Bidakh discusses recent changes to Ukrainian national legislation that updates the state construction norms regulating the construction industry. From Italy, Cesare Caracciolo considers the contractor's liability under Article 1669 of the Civil Code and whether, under this provision, liability includes renovation works.

Our feature articles focus on approaches to contracting in different jurisdictions. From Australia, Sean Kelly and Allison van Beers discuss the public policies developed to promote participation in the Australian market by overseas contractors while also preserving local content and resourcing opportunities.

From New Zealand, Thomas Richards asks whether international concerns about the rule against implied warranties of buildability warrant a change in approach. His article complements the contribution from Joao Ascensao, who draws on his varied experience to consider the distinction between concepts of balanced risk allocation in contracts and balanced standard conditions of contract.

In Asia, we return once more to construction law issues under Korean law. Mino Han and Umaer Khalil discuss statutory liability for defects and the remedy options available.

At a conceptual level, Leendert van den Berg provides an insightful article on common law-style contracts in a civil law world from a Dutch perspective. Delving deeper, Eugenio Zoppis considers ground risk under the contract and the importance of the geotechnical baseline report. He argues that the incorporation of the report into the contract is a valid and effective instrument for risk allocation among parties.

In the last of our feature articles, Tomasz Darowski discusses *rebus sic stantibus* clauses in recent Polish case law, considering whether these clauses make it possible for a court to increase the contractor's remuneration if certain prerequisites are met.

We also have two book reviews in this edition: Jaclyn Masters has reviewed Philip Loots and Donald Charrett's *The Application of Contracts in Developing Offshore Oil and Gas Projects*. Bill Barton has reviewed *The International Application of FIDIC Contracts: A Practical Guide*, coincidentally edited by Charrett.

The ICP is also glad to announce a series of webinars that will discuss diversity and inclusion best practices in the construction industry. Please keep an eye out for further information on this interesting and innovative event which will likely take place later on in the year.

We thank our contributors for their insightful articles and we hope you enjoy reading this edition. You are invited to contribute your thoughts and insights to *Construction Law International* by submitting your articles to CLInt.submissions@int-bar.org.

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FROM THE CO-CHAIRS

Dear fellow International Construction Project Committee members,
We write this message at an unprecedented time in our lives as the Covid-19 crisis affects all of us around the world with widespread personal, social and economic impacts.

As we entered into the new year in January, who could have known that ‘coronavirus’, ‘self-isolating’ and ‘lockdown’ would have become a part of our daily vocabulary. Now, it feels difficult to imagine a time when the world will have returned to normal.

Many of us will be adapting to different ways of working and the balancing act of handling work and family commitments, as well as trying to stay positive among the daily barrage of news and social media reports. However, I have no doubt that we will find a way to adapt to this new normal and maybe even emerge having had an opportunity to reset and re-prioritise.

Among so much bad news, there are glimpses of positivity. We were struck by the reports of messages of support sent with medical supplies from China to Italy – ‘We are waves from the same sea’ – and from Japan to China – ‘We have different mountains and rivers but we share the same sun, moon and sky’.

It seems to us that this is a time where we can understand better than ever the need for organisations like the International Bar Association. Established in 1947, shortly after the creation of the United Nations and the end of the Second World War with the goal of contributing to global stability and peace through the administration of justice, it has grown to have 80,000 members in 170 countries. Today, the IBA stands as a remarkable example of resurgence after a global calamity. Going forward, that worldwide network and that goal will be more relevant than ever.

While we in the ICP Committee are not currently able to meet in person, having taken the inevitable decisions to postpone our Working Weekend in Vevey, Switzerland, and to support the postponement of the Section on Energy, Environment, Natural Resources and Infrastructure Law Biennial Conference in Marrakesh, Morocco, the ICP nevertheless remains strong.

By the time we write this, the IBA Annual Conference in Miami, originally scheduled for November this year, will have been cancelled due to Covid-19. However disappointing this decision is for everyone within the IBA, we all support it and trust that out of this crisis, new opportunities may arise to allow us to connect and interact in different ways. In line with this, the IBA is currently developing an online programme that will give the ICP Committee as well as all other IBA committees, fora and divisions, the opportunity to benefit from the exciting programme we had prepared for Miami with topics such as the distinction between obligations of reasonable endeavours and of good faith performance, alternative procurement in public infrastructure delivery, anticorruption initiatives in construction projects, the use and abuse of variations provisions in construction contracts and more. We are very grateful to all the ICP Committee members who submitted applications to either moderate or speak on our panels, especially those who volunteered for the first time.

We have an excellent team of committed officers who are working hard to ensure that ICP activities continue. There are many ways that members can get involved, including in subcommittee projects and publications, writing for *Construction Law International* and participating on panels. One of the many things that makes the ICP Committee an outstanding committee within the IBA is its openness towards new voices, ideas and perspectives. We very much welcome the participation of as many of our members as possible to contribute to the exchange of knowledge and relationship-building worldwide. All our officers are available to provide information on the ICP Committee and open to receiving ideas and suggestions from members. You can find their contact information on the ICP Committee’s page on the IBA website.

As of this year, the ICP Committee has appointed a team of Diversity Officers whose main role is to ensure that all our functions and panels are balanced in terms of gender, legal background and geographical origin. The Diversity Officers will also work to develop strategies and actions to make the ICP Committee an even more diverse and open committee, following our strong belief that diversity and vibrant content go hand-in-hand.

We also have our online discussion forum, ICP Net (accessible by logging on through the IBA website), and are working with the IBA on other ways to enhance communication with members going forward. At this time, it is more important than ever that we stay connected, so please do visit ICP Net frequently for news, comments and debate.

As hard as it is to contemplate, there is no doubt that at some point this crisis will be over. Rishi Sunak, the UK Chancellor of the Exchequer, said the following on 20 March, and it feels like a good way to close: ‘Now more than at any time in our history, we will be judged by our capacity for compassion. When this is over, and it will be over, we want to look back on this moment and remember the many small acts of kindness, done by us and to us.’

We wish you and your families, friends and colleagues well.

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ITALY

FIDIC around the world: Italy

Arianna Perotti, Milan

For convenience, in this questionnaire, references to FIDIC clauses are references to clauses in the 1999 Red Book.

1. What is your jurisdiction?
Italy.

2. Are the FIDIC forms of contract used for projects constructed in your jurisdiction? If yes, which of the FIDIC forms are used and for what types of projects?

The use of the FIDIC forms in Italy is not widespread, though they are being increasingly adopted by the major Italian construction companies involved in international projects.

Construction contracts concerning public works are regulated in Italy by Legislative Decree No 50 of 18 April 2016 and subsequent amendments (the 'Public Construction Contracts Code'), which have implemented the European Union Directives on Public Procurement. The FIDIC forms contain provisions that are in conflict with several rules of the Public Construction Contracts Code and hence they are not normally used for domestic public construction projects.¹

In domestic private construction contracts, which are primarily regulated by the Civil Code, the FIDIC forms can be applied, but companies are not inclined to use

them as they usually prefer bespoke contracts.

3. Do FIDIC produce their forms of contract in the language of your jurisdiction? If not, what language do you use?

The only FIDIC form available in Italian is the 1999 Red Book. However, in the context of international projects, the English language is preferred.

4. Are any amendments required in order for the FIDIC Conditions of Contract to be operative in your jurisdiction? If yes, what amendments are required?

The FIDIC forms contain a number of provisions that are in conflict with various rules of Italian law, the majority of which, however, are not mandatory and can be derogated.

Among the mandatory rules, one should remember the Italian insolvency legislation. It provides that clauses that link the termination of the contract to the bankruptcy or the judicial liquidation of a party (such as Sub-Clauses 15.2 (e) and 16.2 (g) of the FIDIC Red Book) are null and void.

Another mandatory rule to be considered is Article 1229, paragraph 1 of the Civil Code, which provides that any clause that excludes or limits the liability of the debtor in case of wilful misconduct (*dolo*) or gross negligence (*colpa grave*) is null and void. There is no coincidence between the concept of *colpa grave* and the wording included in Article 17.6, paragraph 3 of the Red Book (Limitation of Liability). Therefore an amendment of this clause is needed in order to ensure adherence to Article 1229 of the Civil Code.

Furthermore, according to Articles 1341 and 1342 of the Civil Code, certain provisions included in the standard conditions or forms particularly favourable to the party that has written them ('Vexatious Clauses') are null unless they are specifically approved in writing by

the other party. The applicability of the regime included in Articles 1341 and 1342 of the Civil Code to the FIDIC forms (general conditions and particular conditions) is arguable (as they may be considered to be prepared unilaterally by one of the contracting parties). However, if one comes to the conclusion that the regime is applicable to the FIDIC contracts, then the Vexatious Clauses included therein would need to be specifically accepted by a double, ad hoc signature.

Several Clauses would be, in such a case, subject to specific approval, for instance: (1) Article 5.4 of the Red Book (Evidence of Payments), as it provides the right to pay a subcontractor directly when reasonable evidence of payments has not been provided to contractor; (2) Article 17.6 of the Red Book (Limitation of Liability); (3) Article 20.1 of the Red Book (Contractor's Claim), which provides a deadline shorter than the one foreseen by the law; (4) Article 20.4 of the Red Book (Obtaining Dispute Adjudication Board's Decision); and (5) Article 20.6 of the Red Book (Arbitration).

5. Are any amendments common in your jurisdiction, albeit not required in order for the FIDIC Conditions of Contract to be operative in your jurisdiction? If yes, what (non-essential) amendments are common in your jurisdiction?

There are several non-mandatory rules of Italian law that may need to be derogated in order to avoid circumstances in which an arbitrator may construe specific FIDIC provisions differently from the parties' expectations.

There are many examples of how this could happen. For example, Article 4.12 of the Red Book (Unforeseeable Soil Conditions) could be considered to be in conflict with Articles 1467 and 1664 of the Civil Code. Article 1664 provides that the contract price may be adjusted if, as a result of unforeseeable

circumstances, there is an increase or decrease in the cost of the materials or labour which lead to an increase or decrease of more than one-tenth of the total price agreed upon. Furthermore, if there are unexpected geological, hydrological or similar causes unforeseen by the parties that make the performance of the Contractor considerably more onerous, the Contractor is entitled to receive a proper indemnification in connection thereto. Article 1467 provides a general principle that is applicable to contracts for continuous or periodic performance. According to this principle, the party whose obligation has become excessively onerous due to extraordinary and unforeseeable events is entitled to request the termination of the agreement. The other party may avoid the termination by offering an equitable modification of the contractual terms.

Furthermore, Article 13 of the Red Book (Variations and Adjustments) does not perfectly match the Civil Code regime regarding variations and adjustment. To give two examples: Article 1661 of the Civil Code gives rights to the Employer to order variations to the project, provided that they do not give rise to an additional cost in excess of one-sixth of the total price agreed upon. Article 1660 of the Civil Code states that the Contractor must perform the necessary variations within the limit of one-sixth of the overall price agreed. If the necessary variations exceed that limit, the Contractor can withdraw from the contract and is entitled to an equitable compensation.

6. Does your jurisdiction treat Sub-Clause 2.5 of the 1999 suite of FIDIC contracts as a precondition to Employer claims (save for those expressly mentioned in the Sub-Clause)?

There is no specific case law regarding Sub-Clause 2.5 of the 1999 suite of FIDIC contracts under

Italian law. In general, notices which the law or a contract required to be delivered to the other party before legal proceedings may be commenced are considered by the courts as preconditions to claims.

7. Does your jurisdiction treat Sub-Clause 20.1 of the 1999 suite of FIDIC contracts as a condition precedent to Contractor claims for additional time and/or money (not including Variations)?

Contractually established notices may be considered to be preconditions to the exercise of claims only if the contractual provisions expressly provide that the right to claim will become extinguished as a consequence of the failure of the relevant party to give the notice. Therefore, the determination of a contractual notice as a precondition to claims depends on a case-by-case assessment of the contract interpretation.

With particular respect to Sub-Clause 20.1, it is likely that the courts would consider the notice foreseen therein as a precondition to the Contractor's claims, since the provision expressly contemplates the extinguishment of the Contractor's right to claim in case of their failure to give the notice.

8. Does your jurisdiction treat Sub-Clause 20.1 of the 1999 suite of FIDIC contracts as a condition precedent to Contractor claims for additional time and/or money arising from Variations?

See answer to question 7 above.

9. Are dispute boards used as an interim dispute resolution mechanism in your jurisdiction? If yes, how are dispute board decisions enforced in your jurisdiction?

Italian law does not specifically regulate dispute boards and hence it has been debated whether the decision of the dispute board could be considered to be a *lodo arbitrale irrituale*, that is, an award having a contractual nature rather than a *res judicata* one, or contractual expertise (*perizia contrattuale*).

Although the dispute board's decisions share characteristics with both legal instruments mentioned, they have a distinctive character: the *arbitrato irrituale* and the *perizia contrattuale* are final and binding upon the parties and their conclusions can be challenged only with remedies regarding the formation of the agreement. By contrast, the decisions of the dispute board can always be challenged by the parties commencing the arbitration procedure.

The decisions of the dispute board, when they become final and binding, still do not have *res judicata* nature. Therefore, if one of the parties fails to comply with the dispute board's decision, the opposing party may file a separate claim for contractual breach by starting arbitration proceedings.

10. Is arbitration used as the final stage for dispute resolution for construction projects in your jurisdiction? If yes, what types of arbitration (ICC, LCIA, AAA, UNCITRAL, bespoke, etc) are used for construction projects? And what seats?

The Italian construction industry frequently refers to arbitration as a dispute resolution device. The Milan Chamber of Arbitration (Camera Arbitrale di Milano) is the most important arbitration centre in Italy for these types of disputes. However, when the construction project includes a foreign entity, the parties usually prefer to choose international organisations. In this context, the International Chamber of Commerce (ICC) is frequently selected with the seat of arbitration in Switzerland (Geneva or Zurich) or in France (Paris).

11. Are there any notable local court decisions interpreting FIDIC contracts? If so, please provide a short summary.

The few available decisions that can be traced are quite dated.

The Court of Appeal of Rome decree dated 12 December 1994

states that the figure of the Engineer does not ensure independence with respect to the other parties or neutrality with regard to conflicting interests.

The Court of Appeal of Rome decree dated 21 July 1997 states that Engineers' decisions have the nature of a *lodo arbitrale irrituale* since the Engineer must be considered a 'quasi-arbitrator'. According to the Court, the fact that the Engineer's decision becomes final and binding if not challenged before the Arbitral panel confirms that Clause 20 provides a multi-tier arbitration system, consisting of two levels: the first, before the Engineer, which is *irrituale* (contractual); and the

second, before the arbitral panel, which is ritual. The Court also rejected the argument that the Engineer lacks independence.

12. Is there anything else specific to your jurisdiction and relevant to the use of FIDIC on projects being constructed in your jurisdiction that you would like to share?

In the same way as other continental legal systems, Italian law contemplates the principle of good faith in the performance of contracts (Article 1375 of the Civil Code), which is most important in contracts of duration that require a certain level of cooperation between the parties. Regardless of specific provisions expressly foreseen in

the contract, the principle of good faith provides for a general duty of solidarity and support, which imposes upon each party the obligation to act in such a way as to preserve the interests of the other party to the extent that such behaviour does not imply an appreciable sacrifice on their part.

Note

- 1 For this reason, the answers to this questionnaire do not refer to Public Construction Contracts Code.

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ITALY

Contractor's liability under Article 1669 of the Italian Civil Code

Cesare Caracciolo, Milan

The Italian Joint Chambers of the Supreme Court of Cassation (Corte di Cassazione a Sezioni Unite or the 'Joint Chambers') has, with the important Decision No 7756 of 27 March 2017 (*L.L. and others v Company P.F. E.C. s.n.c. and others*) provided clarity on one of the key points of contention concerning the application of Article 1669 of the Italian Civil Code: whether the contractor's liability under this provision includes renovation works as opposed to the construction of new buildings only.

According to Article 1669, a contractor will be held liable for total or partial collapse of a building, evident danger of collapse or serious defects in the construction. The contractor's responsibility extends for a period of ten years from the date of completion of the works. Any defective work should be contested formally by the client and notified to the contractor within one year of discovering the defect. Article 1999, paragraph 2 of the Civil Code stipulates that the client then has one year from the time the contractor receives the notice of default to start legal proceedings against the contractor.

Article 1669 differs from the contractor's general liability as set out in Articles 1667 and 1668 of the

Civil Code, which relates to defects in the work that must be notified to the contractor within 60 days of their discovery.

Article 1669 – unlike Articles 1667 and 1668 – provides for a particular form of contractor liability for serious defects, which can only be applied in cases of total or partial collapse and long-term defects of property. This liability applies for a longer term (ten years from the completion of the work) in favour of the client and their assignees.

The rationale for Article 1669 is that in the case of real estate projects that by their nature are destined for long-term use, the correct execution by the contractor can only be confirmed with the passage of time, as problems can occur after a longer period subsequent to delivery.

As will be explained, the jurisprudence related to Article 1669 includes Decision No 7756 of the Joint Chambers, which defines the objective scope of the provision and in particular the concept of 'work' as used in this article.

The question that came to the attention of the Joint Chambers in this case was whether Article 1669 was applicable to defects in new buildings only or also in the renovation or refurbishment of existing buildings.

As will be explained, the answer in the few court cases addressing this issue had been negative until recently, when the Italian Supreme Court of Cassation challenged the assumption and referred the question, as a matter of particular importance, to the Joint Chambers.

According to the more restrictive interpretation of Article 1669 in the previous decisions, renovation works of existing buildings are excluded from its application. According to the broader interpretation, renovation is included in the notion of 'work'.

Given this discrepancy in interpreting Article 1669, it had become crucial for the Joint Chambers to offer guidance on

whether contractors could be held responsible for the total or partial collapse, evident danger of collapse or serious defects in construction of only new buildings or also the renovation of existing buildings.

Notable Supreme Court cases concerning Article 1669

Before Decision No 7756, the Supreme Court of Cassation had considered the scope and application of Article 1669 in several notable decisions.

In Decision No 24143 of 20 November 2007 (Cass No 24143/2007) regarding defective terrace waterproofing as part of the renovation of an existing building, the Supreme Court validated the restrictive interpretation of Article 1669. It stated that the responsibility of the contractor for serious defects in the construction only applies to new buildings. The Supreme Court reached this conclusion on the basis of a strict reading of the text of Article 1669, which links the term 'work' to 'buildings or other real estate property, intended for their long-term nature', concluding that Article 1669 applies to only the total or partial construction of a new building (including in the case of the expansion of a building) and consequently excludes mere repair or renovation of an existing building.

The Supreme Court reached the same conclusion in a similar case (Cass No 10658/2015) concerning the renovation of an existing building that had resulted in serious cracks in the structure. The decision was taken on the basis of different arguments from the previous case, but reached the same result.

More recently, Decision No 22553 of 4 November 2015 (Cass No 22553/15) reconsidered the Supreme Court's earlier ruling. It analysed different criteria regarding the applicability of Article 1669 and applied a less restrictive interpretation. The Court concluded that the responsibility of the contractor for

the total or partial collapse, evident danger of collapse or serious construction defects applies also to renovation works carried out on a pre-existing building when the works affected the essential elements of the property or secondary elements that are relevant for overall functionality, for example, strengthening of the floors and stairs of a condominium building.

Decision No 7756

In Decision No 7756, the Supreme Court, when sitting in the Joint Chambers in its role as interpreter of the law where conflicting precedents exist, outlined the different interpretations followed in previous decisions with respect to the applicability of Article 1669.

In its innovative decision, the Court revised the application of this provision, clarifying that a contractor is liable for renovation works, as well as new construction.

The arguments on which the Joint Chambers based its decision are as follows. In setting out the introductory framework to its interpretation of Article 1669, the Joint Chambers observed how the renovation of existing buildings is compatible with all three situations mentioned in Article 1669: 'collapse in whole or in part', 'evident danger of collapse' and 'serious defects'. In fact, restoration work can cause – both in the restored part of the structure and in adjacent parts of the structure – collapse or danger of collapse. However, the decision recognises that this is mainly the case in circumstances where 'serious defects' affect the renovation works of existing buildings (eg, defects in sealing, cladding and fixtures). Accordingly, the Supreme Court underlined how, while the contractor's liability for collapse or partial collapse of new buildings is intended to protect the client's – and the public's – interest in the soundness of the

structure, the contractor's liability for serious defects in renovation works of existing buildings is intended to protect the client's interest in the enjoyment of the property for its intended use. The Supreme Court observed that, in the case of serious defect, it does not make any difference whether the defect affects a new structure or renovated structure.

The Joint Chambers then observed that this interpretation is confirmed by the historical evolution of Article 1669. Article 1792 of the Napoleonic Code provided for the ten-year liability of the contractor only in the case where the building '*périt en tout ou en partie*', that is, in case of partial or total collapse. Article 1639 of the Italian Civil Code of 1865 (derived from the Napoleonic Code) added the situation of danger of collapse, expanding the liability of the contractor to circumstances where, in the ten years from the completion of the construction of a building or other notable work, 'one or the other collapse in whole or in part, or presents evident risk of collapse'. There was a further and conscious step forward with the addition of serious defects related to renovation works of existing buildings to the provision of the Civil Code, which diverts the focus from the completion of the work to its subsequent use and enjoyment, including defects that affect its functionality, even without compromising the safety and stability of the property.

Moreover, the change in the subject of the provision, from 'building' in the Civil Code of 1865 to 'work' in the current Article 1669, is significant: the Supreme Court observed how such a change would have a semantic reason only if, by 'work', the provision does not mean the building itself, but 'the building activity' that is the object of the contractor's obligation, which can be both the construction of a new

building as well as the renovation of a pre-existing one.

The Joint Chambers also stressed that, on a logical and substantial level of justice, adherence to the restrictive interpretation of Article 1669 would be irrational and not in conformity with a constitutionally orientated interpretation. To interpret the provision strictly would be to treat the initial construction of a building differently to its renovation, when in fact both could result in serious damage to the client.

In light of these considerations, the Joint Chambers determined that the limitation of the meaning of the term 'work' to that of 'construction of a new building' (ie, excluding renovation works) is not justified.

Conclusion

In conclusion, the Joint Chambers, accepting the appeal and resolving the jurisprudential conflict, affirmed the principle that:

'Article 1669 c.c., given all the other conditions, is applicable also to building renovation works and, in general, to maintenance or long-term modifications to pre-existing buildings, which [collapse or] present [obvious danger of collapse or] serious defects that affect the enjoyment and on the normal use of the property, according to its own destination.'

Based on this decision, arguments put forward to support the more restrictive interpretation of Article 1669 do not appear to be endorsed by the Joint Chambers. In particular, the Joint Chambers does not appear to accept the alleged exceptionality of Article 1669 with the consequent prohibition of analogy to circumstances not specifically named in the provision.

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PANAMA

Panama's new public-private partnership regime

Luis H Moreno IV, Panama City

Panama has adopted its first public-private partnership (PPP) regime through Law 93 of 2019 (the 'Law'). It regulates the institutional framework and processes for the development of investment projects in the PPP category, seeking to promote the development of infrastructure and public services, contribute to economic growth, job creation and competitiveness, and to improve the living conditions of the people.

Facing fiscal constraints, and in some cases technical limitations, Panama anticipates benefitting from this initiative by attracting private-sector experience, investment and financing for the development of important projects.

With a few exceptions, the Law is applicable to the central government, autonomous and semi-autonomous entities of the non-financial public sector, municipalities and business corporations in which the state has a majority stake.

It incorporates strong mandatory principles applicable across PPP projects, including transparency, budgetary capacity, appropriate risk allocation, fair competition and integrity. It also includes eligibility factors that will determine the convenience of implementing a given project through the PPP regime. These factors include a

general social analysis that should indicate the benefits of the project to the population; a cost-benefit analysis that would determine the convenience of undertaking the project under the PPP regime versus the traditional public procurement or concession method; a risk distribution proposal including construction, financial, commercial and other risks throughout the different project stages; sustainability and feasibility studies; and legal and environmental analysis.

The scope of work for a PPP project may include design, construction, reparation, financing, expansion, exploitation, operation, maintenance, administration and supply of goods or services to the contracting public entity or to the end users of any public service.

Institutional framework

The governing body, the Ente Rector, consists of the Ministers of the Presidency, Economy and Finance, Public Works, Commerce and Industry, and Foreign Affairs, as well as the Comptroller General of the Republic, who does not have the right to vote.

The Ente Rector is the highest authority in PPP projects. Its responsibilities include:

- defining the priority areas of PPP projects;
- carrying out analysis on the identification, selection and prioritisation of PPP projects;
- approving requests by contracting public entities to undertake projects under the PPP regime;
- approving rules and guidelines for risk allocation;
- approving the scope of work proposed by contracting public entities and the content of PPP agreements; and
- authorising modifications to the tender documents and PPP agreements.

The Law also created the PPP National Directorate (the 'Directorate'). It acts as a technical and operational support

unit for the Ente Rector, preparing for its consideration and approval:

- the selection criteria for PPP projects;
- the standardisation of processes;
- the protocols for collaboration between the various institutions involved in the development process of PPP projects;
- guidelines for risk allocation; and
- the design of the scope of work and PPP agreements, in compliance with the provisions established in the Law.

The Directorate also acts as liaison between the Ente Rector, the contracting public entities and the Advisory Committee.

The Advisory Committee is made up of four members of Panama's private sector, two members of the academic and teaching sector and two members of the organised groups of workers. It raises recommendations and proposes PPP projects to the Ente Rector through the Directorate.

The Ministry of Economy and Finance plays an important role in the implementation of PPP projects as it must coordinate, in accordance with its Budget Classifications Manual of Public Expenditure, the methodology that will be applied to assess the impact of the project on the specific public expenditure of the contracting public entity and the government's general budget during the term of the PPP agreement.

The tender process

The tender documents are made public through a publicly accessible website with sufficient time for review by interested parties. The publication will include the date of a homologation meeting where all interested parties may discuss the tender documents with the contracting public entity. Also, the publication will include the date, place and time for the bid proposal submission.

Once the contracting public entity receives the proposals from the bidders, it will verify that all the

minimum technical, administrative and financial requirements established in the tender documents have been met and then apply the corresponding quantifiable objective valuation method for the economic proposal, as indicated in the tender documents.

The awarded bidder must create a local special purpose vehicle, which will be the actual contractor and will sign the PPP agreement, provide it with the required capital as indicated in the tender document and submit a performance bond. The PPP agreement will enter into effect only after the Comptroller General provides its countersignature to the agreement.

Legal recourses are available for any bidders who argue that their rights were not respected during the tender process.

PPP agreement

The maximum term for PPP agreements is 30 years, with a possible extension of up to 10 years. The Law recognises the possibility of further extensions (up to five years), due to delays attributable to the contracting public entity.

All PPP projects must be at least US\$15m, except for PPP projects undertaken by municipalities, which will be subject to what the regulation of the Law establishes.

The Law classifies PPP projects as 'self-sustaining projects' (entirely financed by the fees and tolls paid by end users) and 'co-financed projects' (requiring or potentially requiring financial contributions from the contracting public entity), depending on the financial commitments assumed by the contracting public entity. In co-financed projects the contracting public entity will assume fixed or contingent commitments, as determined in the corresponding tender documents of the given project.

It is worth mentioning that although constitutionally the Panamanian budget is determined annually by a law approved by the National Assembly, the Law requires that all co-financed PPP agreements contain a provision that obligates the contracting public entity to include the financial resources allocated to pay the PPP contractor in the budgets of the next fiscal periods.

Also, the Law establishes that the Ministry of Economy and Finance will honour the financial obligations acquired by the contracting public entities in PPP agreements and will prioritise the projects in execution.

Dispute resolution mechanisms are contemplated in the Law, starting with an initial stage of direct negotiation to allow a friendly and direct solution between the contracting parties, if applicable. If a friendly solution is not reached between the parties, the technical and/or economic disputes may be submitted for consideration by a technical panel of professionals with outstanding experience in the technical, economic and legal matters of the infrastructure concessions sector. The technical panel will consist of two lawyers, two engineers and a professional specialised in economic or financial sciences. The technical panel will issue an expedited technical recommendation that will not be binding on the parties but may be further considered as evidence by an arbitral tribunal.

All PPP agreements will include arbitration clauses and will establish the regulations applicable to the arbitration proceeding. The applicable law shall be that of the Republic of Panama and the seat of the arbitration will be the Republic of Panama.

The Law also includes 'step-in rights' for creditors to replace the PPP contractor in all its rights and obligations under the PPP agreement if the PPP contractor is

in breach of its obligations under the PPP agreement.

In the same vein, the Law enables the holding company of the PPP agreement to transfer the PPP agreement or its rights under the PPP agreement, but in order to do so, it must first get authorisation from the Ente Rector. Without prior authorisation, no transfer may take place.

Additionally, the Law creates a special pledge in favour of the creditors, which may be agreed between the holding company of the PPP agreement and its creditors. This special pledge may include the rights of the holding company of the PPP agreement, payments of the contracting public entity to the holding company of the PPP agreement and, in general, all receivables of the holding company of the PPP agreement.

Relevant projects

The Panamanian government has publicly referred to a pipeline of projects to be developed under the new PPP regime surpassing US\$2bn. Among the anticipated projects, the government has mentioned: (1) the construction of an 8km cable car system (San Miguelito Metrocable), with seven stations, transporting up to 3,000 passengers an hour, that will cross six municipalities and connect with Panama's two existing metro lines; (2) the construction of a 24km highway (La Costanera highway), connecting the Arraiján-La Chorrera highway to the neighbourhood of Panama Pacifico; and (3) the rehabilitation of an approximately 185km section of the Pan-American highway of between the cities of Santiago and David.

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UKRAINE

Changes to Ukrainian national legislation in 2018 and steps towards harmonisation with European Union legislation

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The year 2018 was replete with legislative changes in the construction industry in Ukraine. Not all of these changes are of fundamental importance, but many of them are influencing the development of the market.

Update on state construction norms

The integration of Ukraine into the European Union has initiated the revision of construction standards to bring them into greater harmony with European codes and standards.

In Ukraine, state construction norms (SCN) regulate the construction industry, including products, processes and services in the field of urban planning, as well as the organisation, technology, management and economics of construction. Most of the existing SCN are outdated and do not meet modern requirements for technology and safety and therefore need to be updated or replaced.

Updates to certain SCN were an important event for the Ukrainian construction industry in 2018. In particular, the updates to the following SCNs were significant:

B.2.2-12:2018 'Planning and development of territories'; B.2.2-4:201X 'Houses and buildings. Pre-school educational institutions'; B.2.2-3:201X 'Houses and buildings. Educational institutions'; B.2.3-5:20XX 'Streets and roads of settlements'; and B.2.2-40:2018 'Inclusiveness of buildings and structures'.

The basic SCN B.2.2-12:2018 'Planning and development of territories', approved by Order of the Ministry of Regional Development, Construction, Housing and Communal Services of Ukraine No 100, dated 23 April 2018 ('Order No 100'), was subject to the most negotiation.

SCN B.2.2-12:2018 regulates the planning and development of territories, transport infrastructure and industrial zones, including the introduction of new altitude restriction lines, the development of green areas, development restrictions for safe evacuation, limitation of the construction density and number of storeys and the like.

Despite the positive nature of the updates to SCN B.2.2-12:2018, some developers sought to prevent these changes from taking effect by filing court claims seeking a declaration that these changes were unlawful and seeking cancellation of Order No 100. These claims have created a situation of uncertainty in the construction industry. On the one hand, when designing construction projects the updated SCN B.2.2-12:2018 should apply. On the other, there is a risk that this SCN will be cancelled. Order No 100 has been suspended and then cancelled by court decision. As of the date of this article, no final judgment has been issued. However, on 1 October 2019 a new SCN B.2.2-12:2019 was approved cancelling B.2.2-12:2018.

Harmonisation of Ukrainian legislation with EU legislation

In 2018, legal acts and regulations were adopted that aimed to

harmonise the legislation of Ukraine with the legislation of the EU. The main changes include:

- Pursuant to the Law of Ukraine on the Energy Efficiency of Buildings, with effect from 23 July 2018, construction projects (in the medium (CC2) and high (CC3) consequences categories),¹ as well as certain existing buildings, are subject to mandatory certification of energy efficiency. Certification of energy efficiency is issued only by a certified energy auditor upon the owner's request and at the owner's expense. An energy certificate is valid for ten years.
- The Law of Ukraine on the Strategic Environmental Assessment became effective on 12 October 2018. The goal of the strategic environmental assessment is to promote sustainable development by ensuring environmental protection and the health and safety of the population, and integrating environmental requirements into the development and approval of state planning documents, including urban planning documentation.
- The Decree of the Cabinet of Ministers of Ukraine No 229 dated 28 March 2018 amended paragraph 3 of the 'Procedure for the application of construction norms developed on the basis of national technological traditions and construction standards harmonised with the regulations of the European Union'.² The amendment set out in the Decree removes design restrictions for CC3 construction projects prohibiting the use of modern Eurocodes during the design of these projects. The restriction was established under the original Procedure because not all relevant Eurocodes had become effective in Ukraine. At present, all Eurocodes have entered into force in Ukraine. Therefore, the implementation of the regulation will allow for the expansion of the scope of SCN developed on the basis of the harmonisation

of national technological traditions with EU regulations for construction projects, regardless of classification.

Other changes in the construction industry

On 9 November 2018, criteria were approved for assessing the degree of risk to a business in the field of town planning and for determining how often a construction project would be subject to state supervision by the authorised architectural and construction control bodies.³

The degree of risk to a business in the field of town planning is assessed using a point system. Depending on the points assigned, a business belongs to one of three categories of risk (low, medium or high), which in turn determines how often it will be subject to scheduled controls:

- for high-risk businesses, controls are scheduled once every two years;
- for medium-risk businesses, controls are scheduled once every three years; and
- for low-risk businesses, controls are scheduled once every five years.

In addition, certain statutory provisions have been improved to stimulate the development of renewable energy sources, in particular wind power generation. These changes provide for the classification of the construction of wind power plants as projects with low consequences (CC1), subject to the positive opinion of the authorised body assessing environmental impact.⁴

If a wind power plant is classified as CC1, construction works can be performed on the basis of a notice of commencement of construction works provided by the customer to

the relevant state architectural and construction control body. For a wind power plant to be accepted for operation, the owner must file a declaration of readiness for operation.

On 31 August 2018, a mechanism of construction amnesty was launched for certain structures built without the necessary authorisation documents.⁵

Construction amnesty applies to CC1 structures including individual dwellings, gardens and suburban cottages with a total area up to 300 square metres. These structures can now be legalised out of court. The main condition is that they must correspond to the designated purpose of the land plot, meet applicable SCN and undergo a technical inspection.

Amnesty is granted after a fairly simple procedure, according to which a resolution on acceptance of the structure into service must be adopted by the authorised architectural and construction control bodies within ten business days from the date of submission of the necessary documents by the owner. If amnesty is granted, no penalties for unauthorised construction or operation are imposed.

In conclusion, the Ukrainian regulatory framework is developing, in particular in the construction industry. Steps are being taken to harmonise legislation with the rules and standards of the EU. How these steps will be implemented in practice and whether the new requirements and standards will actually be enforced remain to be seen. Legislative changes require support from law enforcement practice and judicial practices. This is a subject for further discussion.

Notes

- 1 Under Ukrainian law, real estate projects are divided into those with low consequences (CC1), medium consequences (CC2) and high consequences (CC3), depending on the level of possible danger to human health and life, material losses and social costs.
- 2 Decree No 547 of the Cabinet of Ministers of Ukraine 'On approval the Procedure for the application of construction norms developed on the basis of national technological traditions and construction standards harmonised with the regulations of the European Union' dated 23 May 2011.
- 3 Decree No 899 of the Cabinet of Ministers of Ukraine 'On approval the criteria for assessing the degree of risk of the business in the field of town planning and determined the frequency of scheduled measures of the state supervision (control) at a construction project by the bodies of the state architectural and construction control' dated 31 October 2018.
- 4 2517-VIII Law of Ukraine 'On Amending Certain Laws of Ukraine Regarding Investment Attractiveness of Construction of Renewable Energy Facilities' (4 September 2018).
- 5 Order No 158 of the Ministry of Regional Development, Construction and Housing and Communal Services of Ukraine 'On Approval of the Procedure of Technical Inspection and Acceptance into Service of Individual (Allotment) Dwelling Houses, Garden, Suburban Cottages, Household (Small) Buildings and Structures, buildings and structures for agricultural purposes, by the class of consequences (responsibility) are classified as projects with low consequences (CC1) built on a land plot with the relevant designated purpose without an authorization document for performance of construction works' (3 July 2018).

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Doing business in a 'sunburnt' country – international contractors on Australian projects

Positive change is being enacted to facilitate international participation in Australian infrastructure projects. This paper highlights various factors that are prominent in, and sometimes unique to, Australian projects that international contractors entering the Australian market should pay close consideration to, including: the intersection between statutory limitation periods and projects with long concession periods; opportunities from, and risks of, partnering with local companies in joint venture arrangements; delivery phase procurement (labour and materials) policies, statutory liability for international supply chains and regulated payment processes; and regulatory complexity derived from differing policies across state and territory borders and the federal jurisdiction.

Introduction

With a steady pipeline of large projects, particularly in the resources and transport industries, Australia has seen overseas companies with expertise in those fields venture into the construction market. The presence of international participants is

considered to be positive by governments stocking the pipeline. In June 2019 the Premier of the state of Victoria, Daniel Andrews, said: 'It doesn't matter what part of the world they're from, whether they are from Europe or from China, we need more and more construction capacity to go along with the investments that we're making.'¹

This paper discusses a number of key issues that international contractors should be aware of across all phases of the project lifecycle from tender phase to delivery phase, as well as powerful remedies available in certain types of project-related disputes. Common themes emerge in the paper. Most prominent is the impact of Australia's nine jurisdictions, each with wide-spanning and subtly different regulatory regimes, the complexity of which is demonstrated in the below graphic:

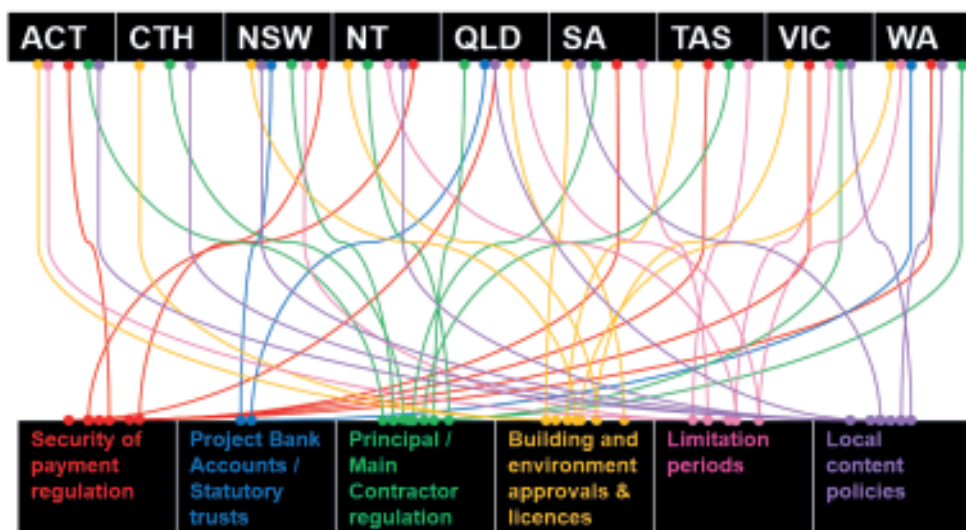


Figure 1: Sample of regulatory regimes across Australia's nine jurisdictions

This makes partnering with a local firm an attractive enterprise structure for overseas participants: local knowledge and experience can be priceless. However, partnering with local firms is not a panacea.

Tender phase: bid cost reimbursement and risk allocation during concession periods

Tenders create a competitive tension that is viewed by many as an essential precondition to achieving the best price that the market can offer. The sophistication of tenders can result in significant sunk costs for losing tenderers.

However, there is the prospect of recouping some tender costs. Bid cost reimbursement regimes are increasingly prevalent in Australia. These regimes increase the range of companies willing to bid for complex infrastructure projects, which in turn drives better solutions and competitive pricing for the project as a whole.

Competitive pricing will also take into account the effects of the local statutory environments. For example:

- contractual defects liability periods (DLPs) intersecting with statutory limitation periods; and
- extended statutory limitation periods unique to the construction industry.

Standard contractual DLPs often run for 12 or 24 months from the contractual date of services completion. However, state and territory legislation create longer periods during which claims for breach of contract, breach of deed or in tort may be pursued by the claimant.

International delivery partners should also be aware of specific limitation periods that apply to 'building actions' that can extend or cap statutory limitation periods on infrastructure projects. For example, section 134 of the Building Act 1993 (Vic) states that: 'despite anything to the contrary in the Limitation of Actions Act 1958 or any other Act or Law, a building action cannot be brought more than 10 years after the date of the occupancy permit in respect of the building work... or [the date of issue] of the certificate of final inspection'.

This provision sets the limitation period for a 'building action' at ten years, meaning that in Victoria, a six-year limitation period for breach of contract may be extended, while the 15-year limitation period for breach of deed may be limited. It also means that a claim in tort for late manifesting damage, delaying when the cause of action accrued, may also be capped.²

Similar building-specific limitation periods apply in jurisdictions across Australia; however, the effects vary. For example, the Australian Capital Territory legislature has expressly enacted a building industry-specific limitation period in section 142(3) of the Building Act 2004 (ACT) with wording designed to preserve other shorter statutory limitation periods.

Related risk allocation devices involve repeating contractual warranties. Statutory limitation periods commence running from the date that the relevant cause of action accrued. Many infrastructure project agreements incorporate 'repeating representations and warranties' clauses, which can have the effect of creating a new breach, and therefore a new accrued cause of action, throughout the term of the project.

For an international participant, the most crucial decision for structuring their role... is whether or not to partner with a local construction company

Commonly used drafting is as follows:

'Unless otherwise expressly stated in this agreement, each representation and warranty given by the delivery partner under this agreement:

- (a) is made on the date of this agreement; and
- (b) is repeated each day during the period from the date of this agreement to the expiry date.'

Such clauses may be necessary where commercial imperatives require that the delivery contractor 'stand behind' the build quality and design life of the works during a long-term concession period, following which the asset is 'returned' to the relevant state or territory. This is frequently necessary for public-private partnership or private finance initiative projects, which usually grant a private-sector operator the right to operate the asset during a concession period that exceeds the standard limitation periods. A first-principles analysis is required on a case-by-case basis to determine whether such clauses contract out of the statutory limitation period(s) that may apply to the project.

Enterprise structures: joint ventures

For an international participant, the most crucial decision for structuring their role in the delivery of an Australian project is whether or not to partner with a local construction company.

Joint ventures are appropriate where multiple forms of expertise or input are required, including technical expertise, networks and funding.

On one hand, the scope of success can be very wide, allowing the international participant to rely on the local company's experience and knowledge. However, the scope of loss from a failed joint venture is also potentially very wide: joint and several liability may bite where a local participant becomes insolvent and the relationship may sour where fiduciary duties contest with each party's commercial goals.

The key advantage of entering a joint venture agreement with a local organisation is relying on the local organisation's experience and knowledge of the jurisdiction and applicable regulations. Approvals and licences required to be obtained or held by a company intending to perform construction work in most Australian jurisdictions include:

- planning and building permits;
- building licences;
- 'Principal Contractor' responsibilities under workplace health and safety legislation; and
- goods and services tax registration.

In addition, where project agreements require contractors to demonstrate utilisation of local labour and/or supplies,³ local participants are likely to be better placed to navigate these requirements.

Regulating the relationship: dealing with fiduciary duties

There is usually some overlap between the duties of a fiduciary and the mutual obligations of joint venture parties. This is because the central aspects of a commercial joint venture often include that the parties work together, and each party exercises discretion for mutual gain. Indeed, fiduciary duties have been found to exist within a joint venture relationship,⁴ even though a joint venture does not automatically create a fiduciary relationship in Australia.⁵

Fiduciary duties involve the imposition of additional obligations on parties, which can hamper a party's ability to pursue

commercial gains. Whether or not a joint venture relationship is fiduciary in nature will often depend on the terms of the agreement, including whether such terms put one party in a position to exercise discretion for the benefit, or at the expense, of the other. It is also possible for a fiduciary relationship to arise before a final joint venture agreement is executed by the parties,⁶ based upon the particular factual circumstances of the relationship and the joint venture project.

Although the precise content of fiduciary duties will vary based on the nature of the relevant relationship, in a joint venture such duties generally involve the fiduciary:

- acting in the best interests of the other party or jointly for all parties and the joint venture as a whole;
- not separately profiting from the relationship (other than fees as agreed and/or indemnification for losses) and accounting for profits;
- avoiding conflicts of interest;
- avoiding obtaining an advantage at the expense of, or causing disadvantage to, another joint venturer in relation to the joint venture project; and
- accounting for an improper advantage if obtained, irrespective of whether the improper advantage was actively hidden from the other joint venturer or could have been discovered by it.

Joint ventures are not standalone legal concepts in Australian law and, because of the lack of general propositions that apply to joint venture arrangements,⁷ the legal and equitable obligations arising from an arrangement that binds joint ventures can be difficult to predict.⁸ This unpredictability can be reduced if the joint venturers are willing to address their mutual responsibilities in a carefully prepared joint venture agreement.

Parties to a joint venture may wish to exclude the role of fiduciary duties from their joint venture relationship. Where commercial certainty is a paramount consideration, it is usually advisable that the parties codify their respective rights and responsibilities in a comprehensive joint venture agreement. There are generally two options for codifying all of the joint venture rights and responsibilities in a joint venture agreement:

- expressly excluding fiduciary relationships and duties; and

- creating contractual obligations that are inconsistent with the imposition of fiduciary duties.

Retaining for joint venturers the freedom to act to their own advantage in their own discretion may preclude the existence of supplementary fiduciary duties.⁹ However, where this freedom of discretion can be isolated to specific activities, fiduciary duties may continue to exist in respect of other activities contemplated by a joint venture agreement.¹⁰

Project delivery

Having successfully tendered for a major infrastructure project and implemented a suitable enterprise structure, an international contractor will encounter a number of issues unique to Australian projects during the delivery phase.

In a vacuum, there are no limits to the ways in which a project can be resourced. Any approach to resourcing is likely to encounter challenges. Despite national employment legislation, workplace health and safety laws vary by jurisdiction, with some jurisdictions requiring head contractors to perform Principal Contractor roles as that term is defined in the legislation.¹¹

Finding a balance between utilising an international participant's knowledge and utilising the local workforce can be advantageous to overseas participants

In the state of New South Wales (NSW), Principal Contractors bear certain responsibilities in relation to managing work sites and construction work, including the creation and maintenance of various work site management plans. This generates a significant administrative burden for organisations not frequently performing the Principal Contractor role in the relevant jurisdiction and places the organisation at risk in relation to breach of the Principal Contractor responsibilities (the penalties for which are significant, including fines and, in certain instances, imprisonment).

Finding a balance between utilising an international participant's knowledge and utilising the local workforce can be advantageous to overseas participants. Although varying by jurisdiction, government policies encourage (and can incentivise) utilisation of the local workforce. For example:

- In Victoria, the Social Procurement Framework¹² and the Local Jobs First Policy, including the Major Project Skills Guarantee (MPSG),¹³ require certain government agencies and bodies to have in place social procurement plans and strategies applicable to tendering and project delivery. The MPSG is a workforce development policy designed to ensure job opportunities for apprentices, trainees and cadets on infrastructure projects.
- In the federal jurisdiction, the Commonwealth Indigenous Procurement Policy¹⁴ aims to stimulate indigenous entrepreneurship and business development by requiring certain commonwealth entities in respect of certain building contracts to meet mandatory indigenous employment (workforce) and supplier use (supply chain) minimum requirements.

Many large Australian infrastructure projects include 'local content' obligations requiring the use of certain proportions of materials and resources sourced from the local jurisdiction. In Victoria, the Victorian Industry Participation Policy (VIPP)¹⁵ is applied when assessing tenders for infrastructure projects. Australia and New Zealand are considered to be a single 'local content' market for this purpose.¹⁶

The process for applying the Local Jobs First Policy in Victoria, including both the MPSG and VIPP, is set out in section 3.2 of the Local Jobs First Agency Guidelines. Step 3 requires the relevant agency to specify the requirements in tender documents. Step 4 requires tenderers to obtain an acknowledgement letter from an independent body, the Industry Capability Network – Victoria (ICN), indicating compliance with local content requirements. A failure to obtain a letter from the ICN means that the tender is not complete, and 'this would mean the end of the procurement process for the bidder'.¹⁷

This approach to promoting local industry is not uniform. For example, the NSW Procurement Board has recently issued the Procurement (Enforceable Procurement Provisions) Direction 2019. Effective from 29 November 2019, the Direction, among other things, precludes a NSW agency from imposing conditions to use domestic content or suppliers, or similar conditions to encourage local development in Australia.

Irrespective of which state or territory policies apply, international contractors can still rely upon international supply chains, but they should be aware of state and territory legislation that can have the effect of imposing manufacturer's warranties on the importer of goods. Under the Goods Act 1958 (Vic), a supplier of goods owes implied duties regarding fitness for purpose and merchantable quality of the goods 'whether he be the manufacturer or not'. This can be beneficial to upstream parties and detrimental to the importer, who may have no control over manufacturing standards in the source jurisdiction.

Finally, progress payment statutory regulation is now relatively common across the world, especially in commonwealth jurisdictions. However, certain aspects of the security of payment legislation across the Australian jurisdictions can trip up savvy international contractors. Key issues include:

- the wide application of security of payment legislation (in respect of both project and claim size);
- rigid and complex regimes (such as the Victorian legislation's approach to payment claims concerning 'claimable variations' and 'excluded amounts'); and
- the multitude of procedural differences between each jurisdiction's legislation.

These critiques might be shared equally by Australian participants. Indeed, the Murray Report¹⁸ recently recommended making security of payment laws nationally consistent. At present, little movement has been made towards this goal.

In a similar vein, the requirement for project bank accounts or statutory trusts in some (but not all) Australian jurisdictions is an example of further regulation of the payment process. In the state of Queensland, three bank accounts are required: a general trust account, a retention trust account and a disputed funds trust account.¹⁹ This can create an additional administrative burden for international participants.

Close-out and recovering losses

This paper will not canvass the various causes of action and associated remedies that may be available on Australian infrastructure projects. However, international participants should be aware of particular remedies that may not be common in their home jurisdiction, but which can be particularly powerful in Australia.

The Consumer Law imposes statutory standards that provide civil entitlements to

The Murray Report recently recommended making security of payment laws nationally consistent

recover losses caused by conduct that is misleading or deceptive, or which may mislead or deceive, or by unconscionable conduct.

These statutory rights apply alongside contractual rights. While it may remain possible to impose monetary limits on liability via contractual provisions,²⁰ it is not possible to exclude altogether the operation of the standards, which have been recognised as serving public policy. Accordingly, contractual time bar provisions may be effective to prevent a party from bringing late claims under a contract; however, that party may still be able to bring claims under the Consumer Law irrespective of failure to comply with contractual notice provisions.²¹

Some overseas jurisdictions have been more willing than Australia to imply obligations of good faith into all commercial contracts as a matter of law; however, that is not the law of Australia.²² This is partly offset by the relatively broad statutory obligations to avoid misleading or deceptive conduct. Subjective intent to mislead or deceive is not required to be in breach of these statutory standards. This can come as a surprise to some overseas participants and it can provide remedies that they might not have thought they had access to.

Conclusion: recurring themes

To take full advantage of the recent boom in infrastructure projects across Australia, international contractors must be aware of and fully understand the large number of policies and regulations that apply to Australian projects, which often differ across the various state, territory and federal jurisdictions.

Notwithstanding the regulatory maze, there remains great opportunity for international contractors. The need to diversify expertise on Australian construction projects has been recognised and policies are being implemented to achieve this outcome.

Notes

- 1 Clay Lucas and Timna Jacks, 'Losers paid out in transport bids', *The Age*, accessed 14 June 2019.
- 2 *Briek Industries Pty Ltd v McKenzie Group Consulting (Vic) Pty Ltd* [2014] VSCA 165.
- 3 See Local Jobs First – Victorian Industry Participation Policy.

- 4 *Blong Ume Nominees Pty Ltd v Semweb Nominees Pty Ltd* (2017) 123 ACSR 19.
- 5 *United Dominions Corporations Ltd v Brian Pty Ltd* (1987) 157 CLR 1, 10.
- 6 See arguments raised in *Noble Earth Technologies Pty Ltd v Hampic Pty Ltd (in liq) (t/as Cyndan Chemicals)* [2017] NSWSC 502 and *Management Service Australia v PM Works* [2017] NSWSC 1743.
- 7 See n 5 above.
- 8 For example, compare *Blong Ume Nominees Pty Ltd v Semweb Nominees Pty Ltd* (2017) 123 ACSR 19 with *Red Hill Iron Ltd v API Management Pty Ltd* [2012] WASC 323.
- 9 *Ibid*, *Red Hill Iron*.
- 10 *Ibid*.
- 11 See, eg, harmonised legislation: Work Health and Safety Act 2011 (ACT), Work Health and Safety Act 2011 (NSW), Work Health and Safety (National Uniform Legislation) Act 2011 (NT), Work Health and Safety Act 2011 (Qld), Work Health and Safety Act 2012 (SA) and Work Health and Safety Act 2012 (Tas).
- 12 State Government of Victoria, *Victoria's social procurement framework*, April 2018, www.content.vic.gov.au/sites/default/files/2018-08/Victorias-Social-Procurement-Framework.PDF
- 13 Provided for by the Local Jobs First Act 2003.
- 14 Australian government, Department of the Prime Minister and Cabinet, *Indigenous Procurement Policy overview*, 26 November 2018, www.pmc.gov.au/resource-centre/indigenous-affairs/indigenous-procurement-policy-overview
- 15 Which is also part of the Local Jobs First Policy of the Victorian government.
- 16 Local Jobs First Policy (October 2018), p 4, s 5.1.
- 17 Local Jobs First Agency Guidelines (October 2018), pp 3–4, s 3.2.
- 18 John Murray AM, *Review of Security of Payment Laws* (December 2017), https://docs.employment.gov.au/system/files/doc/other/review_of_security_of_payment_laws_-_final_report_published.pdf
- 19 See Building Industry Fairness (Security of Payment) Act 2017 (Qld).
- 20 For consideration of monetary caps on liability, see *Owners SP 62930 v Kell & Rigby* [2009] NSWSC 1342, *Lane Cove Council v Michael Davies & Associates and Others* [2012] NSWSC 727 and *Firstmac Fiduciary Services Pty Ltd & Anor v HSBC Bank of Australia Limited* [2012] NSWSC 1122.
- 21 See *Brighton Australia Pty Ltd v Multiplex Constructions Pty Ltd* [2018] VSC 246 where a time bar was found to be inapplicable in respect of a claim made under section 18 of the ACL as it was found to be void for being against public policy. See also *Omega Air Inc v CAE Australia Pty Ltd* [2015] NSWSC 802.
- 22 See *Aurizon Network Pty Ltd v Glencore Coal Queensland Pty Ltd & Ors* [2019] QSC 163 for a detailed discussion of this issue.

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Balance in construction contracts – the case for two-sided certainty

When Paul pointed out in his first letter to the Corinthians that ‘we now are and have everything only provisionally, with reservations’,¹ he was presaging the development in the 15th Century of the principle of *clausula rebus sic stantibus*. With few exceptions, this principle is unwelcome in the context of commercial dealings and jurisdictions worldwide have steered away from the clause. The binding force of contracts is a key assumption, as contracts ideally require a high degree of certainty.

In extremis, this results in contracting parties being bound to comply with their obligations no matter how burdensome they may become within the contractual framework, even in the context of agreements where uncertainty is high from the outset. Common law courts are not likely to rectify a bad bargain as in *Bottoms v York Corporation*,² and, as described later in this paper, there could be unpleasant surprises in store for those who expect civil law courts to decide otherwise.

The FIDIC notes to the 2017 editions of the Red and Yellow Books indicate that the

respective conditions of contract continue ‘FIDIC’s fundamental principles of balanced risk sharing’. But the quest for standard conditions of contract with balanced risk allocation is ineffective, for one individual’s view of balance is unlikely to match another’s. In reality, standard conditions have limited influence on the risk allocation of construction contracts as such allocation is often determined by ad hoc contractual documents, including the particular conditions, the scope annex or the technical specifications. Furthermore, the uniqueness of each construction project, combined with distinct idiosyncratic aspects of multiple stakeholders and specific external environments, result in different perceptions of risk that will inevitably have an influence on how balance is viewed.

This article draws a line between the concepts of balanced risk allocation in contracts and balanced standard conditions of contract in the context of the construction industry and proposes a mechanism to enhance the latter, focusing on the principle of certainty.

In *pacta sunt servanda* we trust

The binding force of contracts is a central principle both in the common law context and in civil law jurisdictions, albeit arguably less strictly in the latter. It is for the parties to agree on provisions that may limit their respective risks and responsibilities – and limitation-of-liability clauses are arguably the most prominent example of such provisions.

These clauses may have a considerable effect in reducing contractors' overall risk in design-and-build agreements. However, the effect is only partial. Typically, contractors are expected to meet their contractual obligations even in cases where the associated cost becomes unreasonably high, with the result that contractors are exposed to unlimited cost overruns. In cases where uncertainty is high it is not commercially rational for contractors to enter into agreements that lack contractual protection for disproportionate cost overruns, in contrast to alliance contracts popular in many common law jurisdictions. But rationality fades when contractors need to secure jobs.

The standard conditions that design-and-build contractors typically take on imply that they are to deliver their end of the bargain, apart from limited exceptions, at a given price, no matter what the cost is.

Contractors may overestimate the extent of protection afforded by limitation of liability provisions. Given the prominence of these clauses, and their convenience by seemingly simplifying a complex subject by means of establishing caps and sub-caps, contractors can be drawn to confuse the concepts of limiting liability and limiting risk. However, the latter is a much wider concept.

Pacta sunt servanda and civil law

The prominence of the 13th-century concept of *pacta sunt servanda* in the common law context is unquestionable, but similar significance exists in civil law countries.

In Spain, 'the debtor, despite the fact that it cannot and shall not deliver on an impossible obligation, will nevertheless be liable to the creditor for the effect of not satisfying his part of the bargain'.³ In Portugal, the public contract law imposes a contractual obligation on public entities to restore the economic equilibrium of contractors in certain exceptional circumstances. However, in addition to the exceptional character of the circumstances covered, contractors' entitlements are limited to

situations where 'the causing factor leading to the unbalance is not included in the normal business risk which the contractor should assume'.⁴

This topic is explored in a paper on the subject of the 2002 Brazilian Civil Code, in which the author reflects on how the principles of *pacta sunt servanda* and *rebus sic stantibus* coexist. Emphasis is given to the highly relevant role of risk allocation in contracts, indicating that

'we are to associate this subject matter with that of risk. Being in the presence of the contract's own risks shall not justify the contract's termination or revision due to excessive onerosity'.⁵

Risk: a concept wider than liability

Having liability limited under contracts only partially deals with contractors' overall risk in respect of contractual obligations and assumed responsibility. This is evident in design-and-build lump-sum contracts, where contractors assume the risk of completing work for a given price, regardless of the actual quantities needed. In the case of a significant increase in quantities for reasons not attributable to the employer, which result in the actual cost of the project to the contractor being 50 per cent more than the

The binding force of contracts is a central principle both in the common law context and in civil law jurisdictions

agreed price, the contractor would not be able to rely on a 25 per cent contractual liability cap, as such provision would not be relevant for cost overruns. The (ir)relevance of such a cap would come into play in a hypothetical case in which a contractor would take the decision to discontinue carrying out the work, in essence taking the commercial choice of not complying with its contractual obligations due to a disproportionate economic burden.

If such a breach of contract took place, and as a result the employer terminated the contract and found an alternative contractor to perform the work, naive contractors could argue that their liability would be limited to 25 per cent of the contract price. Under this argument, the risk of quantities would be covered by the liability cap. However, limitation-of-liability clauses often

have exclusions. One such exclusion may be – as in the case of the FIDIC rainbow suite – deliberate default. Not proceeding with the works in this scenario would be construed as the contractor’s deliberate default and there would be no contractual cap to liability. Arguably the contractor would be better off had it chosen to complete the work itself, incurring losses that would be, nevertheless, under its management.

Abraham Lincoln wrote in a letter: ‘My old father used to have a saying, that, “If you make a bad bargain, hug it all the tighter.”’⁶ This may be a good piece of advice.

Insurance, limitation of liability and then, no bounds

For contractors, the most critical exposure from such risks would be: liability to third parties, liability to the employer and, in a broad sense, cost overruns to be borne by the contractor.

Third-party liability is typically covered by insurance. Contractors’ liability to the employer may be capped, subject to certain exceptions, by limitation-of-liability clauses. Yet, a contractor’s risk for cost overruns is normally unlimited under typical contractual frameworks. Typically, cost and buildability risks rest with the contractor, especially in the common law context, as the approach in *Thorn v Mayor and Commonalty of London*⁷ demonstrates.

A contractor’s risk for cost overruns is normally unlimited under typical contractual frameworks

In addition to insurance and limitation-of-liability clauses, there are other common mechanisms that limit contractors’ risks, such as exclusion of indirect and consequential losses, liquidated damages (ascertained losses for delay and other events), defects liability periods (limiting the contractor’s mobilisation onsite) or force majeure provisions (a shared risk), to name a few. Nevertheless, while providing some protection, these do not change the fact that contractors typically face the risk of unlimited cost overruns. This is central to the concept of *pacta sunt servanda* as adopted in most standard forms.

Where balance is determined and risk is allocated

Standard conditions of contract will inevitably have an influence on risk allocation, but such influence may be neutralised by other contractual documents.

This article will not go into the debate of where risk should lie and who is the party best suited to deal with certain risks. This article is concerned with balance. So how is balance determined? There are two evident sources of balance. On the one hand, there is the job to be delivered by one party, added by the risk it assumes, versus the price to be paid by the other party. The greater the job and its risk profile, the greater the price should be. The right price affords balance. On the other hand, balance is determined by the nature of the clauses that apply to each party. For instance, where strict notification periods apply to one party but not the other, balance is absent. Also, when strict termination provisions apply to one party but not the other, balance is missing. The latter topic will be further explored later.

For standard conditions of contract, the discussion of which party is best suited to deal with a certain risk is less relevant as standards are designed for use in multiple contexts with significantly different parties involved depending on the project. One party may be better suited to deal with a certain risk than another. Conversely, one cannot expect to find the standard formula for balanced risk sharing – specific parties may find balance by negotiating the right price in each contract.

Balanced standard conditions should be about balanced provisions, not an exercise of imagining what the right formula for balanced risk sharing should be for unknown parties and circumstances. In some cases provisions should be mirrored rather than one-sided; for example, a time bar provision that results in a waiver of rights to one party should be matched by a symmetrical provision the other way around. Balance in other cases can only be achieved by recognising the lack of symmetry between the parties, as fundamentally the contractor brings buildability and supply-chain management to the table, where typically the employer has obligations for payment, provision of the site and a design brief. The balance will change on a project-by-project basis.

A two-sided termination provision

Employers in construction contracts typically have the ability to terminate contracts for convenience, such possibility normally being tied with the obligation, inter alia, to compensate contractors for costs already incurred or committed. Standard contracts with such a provision will arguably fail the balance test in case a similar right does not apply to contractors.

It would be naive to expect balance in the termination provision to be viewed favourably by employers. It is probable that their major concern would be that contractors could feel encouraged to walk away in cases where interim results fail to meet expectations. This is a fair concern at first sight, but does it pass the reasonableness test? In other words, is it reasonable that one party may terminate for convenience, while the other is barred from it?

Objectively, this results in an unbalanced relationship, so the question here really is whether an unbalanced contractual provision is reasonable and the answer is not clear cut. To assess the reasonableness of such a contractual provision, one must not only look at the provision itself, but also at the effect that such provision may have on the affected party. While the effect to contractors of a termination for convenience by employers may typically be assessed within the framework of the contract, the effect of contractors walking away is much more difficult to assess, as the effects suffered by employers will likely be exterior to the contract.

For an employer, the decision of whether or not to proceed with a project will be driven by matters external to the contract – a change in market forces or the commercial driver for the project. In that case, the accepted position is that the contractor is compensated for committed cost but not lost profit on the uncompleted balance of the project. For its part, the employer typically is constrained from engaging another contractor to complete the work.

This being the case, balanced contractual provisions would not necessarily result in a balanced contract.

Or would they?

Enter the principle of certainty. For any sensible allocation of risk, the reduction of uncertainty before finalising contractual responsibilities is critical. Some risks, however, can only be pushed off to be dealt with in the contract framework – force majeure, or for

the purposes of this paper, termination either by agreement or at the will of either party.

Employers require the option to terminate where the job contracted ceases to make sense from its perspective, say because the price to build has become too high, because the final product is no longer needed or it has a better use for its resources. Further, contracts usually narrowly prescribe the effects of such termination for convenience of employers. This provides certainty to employers. To find balance, such certainty should be two-sided – that is, contractors should have a comparable right. In fact, a scenario where a contractor expected five per cent profit in a project and was faced with a five per cent loss is not shocking. But if the loss to be incurred was, say, 50 per cent of the contract price, corresponding to ten times the budgeted profit, the rationality of the bargain may start to fade.

Is it reasonable that one party may terminate for convenience, while the other is barred from it?

What about the effects of such right? In provisions of termination for convenience by employers, certainty is typically provided to contractors. Certainty shall also be afforded to employers in case a provision for termination for convenience of contractors is established.

However, balance here should not be measured alone by comparing the effects to each party. The risk–reward equation applicable to each individual party must also be considered and while contractors should not be released from their obligations lightly, balanced limits should be established. There are existing mechanisms that may be used for this purpose, which provide certainty to both parties. These include contractually capped delay liquidated damages that may apply to accrued deviations to the work programme for which the contractor is responsible, as well as liability for defects and third-party liabilities, which would not be waived in a termination for convenience scenario.

Contractors' entitlement to be released from the obligation to proceed should not be abrupt. Employers should have the option of entering a negotiation process with the objective of finding alternatives to proceed with the work, possibly in the form of mediation, and there should be step-in

clauses for key subcontracts. Any such clause should have a balanced nature – it would be no good to create a mechanism that would fail to reasonably provide employers with a safety net. Pragmatically, there is a mutual interest in engaging in such negotiation if a project is going off the rails for either party, whether the employer’s commercial drivers or ability to fund the work have changed, or the contractor has encountered a rampant cost overrun. Neither party has a long-term interest in holding the other’s feet to the fire.

As previously noted, in order for certainty to be two-sided, following termination for convenience by contractors, liquidated damages and liability responsibilities should kick in where applicable. In addition, a release fee may be appropriate, say, five per cent of the contract price. In the case of a contract with limitation of liability of 30 per cent of the contract price and a liquidated damages cap of 15 per cent, the contractor could find themselves having to disburse 50 per cent of the contract price in order to be released of its obligations (adding the five per cent release fee to the two caps).

A piece of two-sided *rebus sic stantibus*

Termination-for-convenience clauses provide certainty to the parties in the spirit of *rebus sic stantibus*. Such provisions mean that parties may be released of their contractual obligations in cases where the bargain ceases to make sense to either of them. This right

will not prejudice the certainty of the other party in case the effects of the termination are appropriately set.

The advice by Lincoln’s father applies to construction contracts: Contractors should hug bad bargains all the tighter. But before getting into contracts, it should make sure it has a way out in case the contract becomes unreasonably burdensome. Certainty via *rebus sic stantibus*.

Notes

- 1 Karl Barth, *Church Dogmatics, Volume III, The Doctrine of Creation, Part 4* (T&T Clark 1961).
- 2 *Bottoms v York Corporation* (1892) Hudson’s BC (4th Edition, vol 2) 208 at 225.
- 3 Luis Diez-Picazo et al, *Sistema de derecho civil* (Editorial Tecnos, 2001), author’s translation from the original.
- 4 Jorge Andrade da Silva, *Código dos Contratos Públicos – Comentado e anotado* (Almedina 2018), author’s translation from the original.
- 5 José de Oliveira Ascensão, *Alteração das circunstâncias e justiça contratual no novo Código civil* (Conselho da Justiça Federal, Centro de Estudos Judiciários 2004), author’s translation from the original.
- 6 Ward Hill Lamon, *The Life of Abraham Lincoln* (Applewood Books 2012).
- 7 *Thorn v Mayor and Commonalty of London* (1876) 1 App Cas 120 (HL).

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Skyline view at Mt. Eden in Auckland, New Zealand. Credit: ti1993/Shutterstock

Builder beware?

Do international concerns with the rule against implied warranties of buildability warrant a change in approach for New Zealand?

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Introduction

Freedom of contract means parties are free to undertake the impossible. So where a contractor agrees to complete a project, they bear the risk of that task proving impossible. Generally, a principal will have no reason or inclination to assume that risk and only an express contractual provision will persuade a court they have done so. In short, principals do not implicitly warrant the buildability of projects.

However, a number of authorities from throughout the Commonwealth (and the

governing authority in the United States) challenge the utility of the orthodox approach on the basis that it places an unworkable burden on prospective contractors and fails to effectively pair risk with control.

It is clear, both from practical experience and from the collapse of several large players in the industry over recent years, that risk (including buildability risk) is not always well managed by the New Zealand construction industry.

Nevertheless, this article contends that international challenges to the orthodoxy do not justify a change of approach in New Zealand.

The current approach does pair risk with control and the burden it places on contractors (while not light) is not unreasonable. In fact, the most viable response to buildability risk is for contractors to make use of existing tagging processes and to adopt a more conservative approach to tendering (including, when necessary, simply walking away).

In common law, the same principle allocates the risk of both buildability and sub-surface conditions to contractors by default. This article examines authorities relating to both kinds of risk in discussing that underlying principle. However, as a practical matter, standard provisions usually alter the default allocation of risk for sub-surface conditions. Accordingly, the observations in this article apply only to buildability risks (such as inconsistent details that need to be reconciled, often giving rise to delays and additional costs) which are still governed by the common law.

Increasingly, principals are using early contractor input to identify buildability issues

Increasingly, principals are using early contractor input (ECI) to identify buildability issues. While this article does not discuss ECI, contractors should note that it does not affect the allocation of buildability risk (which contractors always shoulder by default); it is simply a practical attempt to ameliorate risks that principals have an interest in avoiding – whether or not buildability is its risk.

Orthodox approach to buildability

The orthodox Commonwealth approach to the impossibility of construction works is that if a contractor warrants that it will perform certain work, the actual impossibility of performing it is no excuse for non-performance.

It is the contractor's responsibility to carefully inspect the design before agreeing to carry it out.¹ If the contractor then warrants that it will complete the works according to the principal's design, the fact that the design is not capable of construction will not give the Contractor any right to extra payment or time, unless the principal has expressly warranted the design's buildability.²

This rule has greater force where the

design is prepared by a consultant to the principal. The principal is not responsible for the possibility or practicability of the design unless the principal expressly agrees otherwise.³

Hudson puts it this way:

'The cardinal principle, in the absence of an express disclaimer, is that an Employer who uses a professional adviser does not warrant that completion according to the adviser's plans or design is practicable... In consequence, any additional work necessary to achieve completion must be carried out by Contractors at their own expense if they are to discharge their liability under the contract, and will not qualify for additional payment as a variation even if they had been formally instructed to do the work in question.'⁴

As Hudson explains, there are very good reasons for this allocation of responsibility:⁵

'The expertise of an Employer's designer is regarded as lying in the design of the final permanent work in place, so as best to meet the amenity and other needs of their client. Those needs may involve greater or lesser elements of durability, quality and post-contract performance, or of ease of maintenance and amenity, for example. In designing to meet those needs, the element of ease of construction or "buildability" is of purely secondary importance [...] On the other hand, the expertise of the Contractor and its success in business competition against its rivals depends on skill in the quite different area of "buildability", that is, on the "how", not the "what", of construction.'

Thorn v Mayor and Commonalty of London

The leading Commonwealth authority on buildability is *Thorn*.⁶ The case concerned the replacement of Blackfriars Bridge in London.

At the time, the conventional method for putting in pier foundations employed coffer dams, but the specification put out for tenders required prospective contractors to use particular iron caissons.

It transpired that the specified iron caissons were inadequate and buckled under pressure. Ultimately, the foundations were put in by working on the sound lower parts of caissons at low tides (which took longer) and the contractor claimed against the principal for the additional time and labour required by the failure of the caissons.

Deciding in favour of the principal, the House of Lords held that:⁷

- when a principal invites tenders for work according to certain specifications, this does not imply a warranty that the work can be carried out according to those specifications;
- before submitting a tender, a tenderer should fully inform itself of all the particulars of the work, especially the viability of doing the work according to the specifications. If necessary, the tenderer should seek advice from an expert in order to properly understand the specifications; and
- if a tenderer relies on a specification provided by a principal, rather than examining it for themselves, that is 'blind confidence of the most unreasonable description'.⁸

The House of Lords also observed, in the following passage, that the contractor could have protected itself from the risk of the design not being buildable:⁹

'If the [Contractor] had considered, as he was bound to do, the terms of the specification, he would either have abstained from tendering for the work, or he would have asked the [Principal] to protect him from the loss he was likely to sustain if the [...] specification should turn out to be an improper one.'

The specification in *Thorn* also included a number of disclaimers by the principal in relation to the information provided to tenderers. A common misconception is that those disclaimers played into the decision reached by the House of Lords. For completeness, it should be noted that the lords only referred to those disclaimers in the course of rejecting an argument that they were relevant.¹⁰

Tharsis Sulphur and Copper Co v McElroy & Sons

The following year, the House of Lords was confronted with the issue of buildability again in *Tharsis*.¹¹

The contractor in that case undertook to build a factory according to a specification that called for unusually light iron girders. During construction, the contractor found that casting girders of the specified weight was difficult (if not impossible). The contractor sought permission, which the engineer to the contract granted, to use additional iron in casting the girders. The use of additional iron increased the cost of completing the works, and the contractor claimed payment for the difference.

The House of Lords held that the principal was not responsible for the specification difficulties and was not liable to pay. The contractor was obliged to complete the work that it had contracted to complete; if the contractor encountered any difficulties in doing so, that was a risk it had taken.

The early English authorities are clear: all things being equal, the contractor's agreement to undertake specified works means the contractor is responsible for completing those works, even if the specifications are difficult or impossible to comply with.¹²

Wilkins and Davies v Geraldine Borough

Those principles were expressly adopted in New Zealand in *Wilkins and Davies v Geraldine Borough*.¹³ The court in *Wilkins and Davies* distinguished the earlier New Zealand authority of *Thomas v Amuri County Council*, which (with respect, wrongly) concluded that *Thorn* did not allocate the risk of assumed facts to contractors.¹⁴

The contract in *Wilkins and Davies* provided for a concrete tank floor to be poured in dry conditions and to that end the specification provided for a 44-gallon drum to act as a well. It transpired that neither a 44-gallon drum, nor even a 400-gallon drum, was sufficient to keep the area dry. The contractor was forced to adopt a different approach.

The contractor brought claims alleging the principal was in breach of implied warranties as to the physical conditions on site and the viability of the specification. The court expressly approved of both *Thorn* and *Tharsis* in rejecting those claims, observing that:

'Any claim that there is a warranty to be implied that the work can be done in the way and under the conditions in the specification was rejected by the House of Lords in *Thorn v Mayor and Commonalty of London* (1876) 1 App Cas 120.'¹⁵

International challenges to *Thorn*

Thorn is the orthodoxy in the Commonwealth, but the US has recognised implied warranties of buildability for more than a century and there is a growing body of Commonwealth decisions questioning or quietly challenging *Thorn*. All of those unorthodox Commonwealth decisions post-date *Wilkins and Davies* and raise the question of whether or not New Zealand should continue to follow *Thorn*.

Australia and Canada

AUSTRALIA

By and large, the Australian authorities adopt reasoning consistent with *Thorn*.¹⁶ But a number of decisions (even at the highest level) challenge the idea that contractors should be responsible for informing themselves about a project.

In *Codelfa Construction Pty Ltd v State Rail Authority*, Mason CJ expressed the view that it was good common sense for contractors to educate themselves about all details of a project before tendering, but that the comment in *Thorn* that contractors *ought* to do so,

‘cannot be elevated into an absolute rule of law – its value and force necessarily depends on the relationship between the parties and the arrangements which they make’.¹⁷

Thorn is the orthodoxy in the Commonwealth, but the US has recognised implied warranties of buildability for more than a century

More pointedly, in *Morrison-Knudsen International v The Commonwealth*, the High Court read down a principal’s disclaimer of the accuracy of tendering information so that it applied only to ‘inferences or conclusions [...] the tenderer might’ draw from that information. The Court reasoned that the contractor’s limited opportunity to gather information for itself effectively forced it to rely on the information provided.¹⁸

CANADA

A number of Canadian authorities have either questioned the approach in *Thorn* itself¹⁹ or have allowed Contractors to claim against Principals’ engineers for negligent misstatement.²⁰ In both situations, the relevant courts reasoned that in certain circumstances (particularly where tendering processes were condensed) a contractor should not be expected to reach its own conclusions.

The Canadian courts in particular have also taken issue with the fact that principals’ engineers (designers) do not bear the risk of the buildability of their own designs, instead requiring contractors to hire their own engineers and do the work again.

THE COMMON CONCERN

The common theme underlying those Australian and Canadian challenges is that

Thorn fits awkwardly with the realities of tendering in today’s construction industry, in particular because of:

- the unequal opportunities given to principals and contractors to gather information and examine proposed designs; and
- the apparent duplication of design responsibilities between the principal’s engineer (the designer) and the contractor.

The US

THE *SPEARIN* DOCTRINE

The US has never followed *Thorn*. The leading authority for the US approach to buildability is *United States v Spearin*, which cleanly summarised the position as follows:

‘if the Contractor is bound to build according to plans and specifications prepared by the owner, the Contractor will not be responsible for the consequences of defects in the plans and specifications [...] This responsibility of the owner is not overcome by the usual clauses requiring builders to visit the site, to check the plans, and to inform themselves of the requirements of the work’.²¹

However, while *Spearin* summarised and affirmed the US approach, the Supreme Court did not unpack its underlying rationale. Rather, that rationale is to be found in the earlier authorities affirmed in *Spearin*, one of which (*Bentley v State*) is particularly relevant as it expressly considered and distinguished *Thorn*.

BENTLEY V STATE

*Bentley*²² concerned the construction of a new wing for the Wisconsin Capitol Building. The project was funded by an act of the state legislature, which passed before tenders were sought. Predictably, even the lowest tender exceeded the authorised budget.

The superintendent amended his specification – by reducing the dimensions of cast-iron structural members²³ – and asked the lowest-priced tenderer to re-price the project on that basis. The re-priced tender was within budget and was accepted. All of this occurred in the course of a single meeting.²⁴

Ultimately, the weight of the structure proved too much for the diminished cast-iron members and it collapsed before construction was complete. The contractor brought a claim for the costs of repairing works damaged by the collapse.

The Supreme Court of Wisconsin accepted

that the principal had to be responsible for the collapse of the building because it had chosen to provide an inadequate design, in circumstances where the contractor would only be paid for complying with that design: the principal forced the contractor to build an inferior building and the principal was therefore responsible for the consequences.²⁵

The Court declined the state's invitation to follow *Thorn*, reasoning that the principal in *Thorn* retained very little control over the part of the works that included the defective caissons, while the superintendent for the state retained 'the right to determine all questions relating to the material and workmanship'.²⁶

THE RATIONALE

The logic behind the *Spearin* doctrine, illustrated clearly in *Bentley*, is that responsibility for design goes hand-in-hand with control over design. While the Supreme Court in *Spearin* did not say so directly, that rationale is also completely consistent with the following passage of its reasoning:

'the insertion of the articles prescribing the character, dimensions and location of the sewer imported a warranty that if the specifications were complied with, the sewer would be adequate. This implied warranty is not overcome by the general clauses requiring the Contractor to examine the site, to check up the plans, and to assume responsibility for the work until completion and acceptance'.²⁷

England

In an apparently sharp departure from *Thorn*, the English Court of Appeal accepted, in *Bacal v Northampton Development Corporation*,²⁸ that the principal in a design-and-build housing development project impliedly warranted that ground conditions at the site would be consistent with borehole samples provided to tenderers.

The principal provided prospective tenderers with the results of borehole soil samples, which indicated the soil at the site comprised 'Northamptonshire sand and upper lias clay'.

Tenderers were required to submit alongside their tenders substructure designs and priced schedules of quantities for six sample blocks, which would then be used to prepare a schedule of quantities for the whole project. Tenderers were also instructed to prepare those documents on

the assumption that the borehole soil samples accurately reflected conditions on site.²⁹ In fact, the site contained deposits of a spongy material, which meant that affected foundations had to be redesigned.

After referring to the principal's direction to assume the borehole samples were accurate, the Court found that the principal impliedly warranted that ground conditions at site would be consistent with those samples. That finding ostensibly accepted the contractor's argument that it could not price and plan a 'comprehensive development' without knowing the ground conditions at site, but it is clear the result also hinged on the fact that the principal instructed tenderers to make an assumption about conditions at site.

Contractors will often simply rely on information provided by the principal to make the tender work

Accordingly, *Bacal* can be viewed as authority for the proposition that a principal who directs tenderers to make a particular assumption impliedly warrants that assumption to be accurate.³⁰ In turn, that proposition reflects the concern that risk should be paired with control, although (unlike *Spearin* and *Bentley*) *Bacal* focused on control during the tendering process.

Evaluating the concerns: is a departure from *Thorn* warranted?

The upshot of the preceding discussion is that there appear to be two substantive concerns underlying decisions that challenge (slightly or significantly) the default allocation of risks to contractors under *Thorn*. Those concerns, against which *Thorn* is evaluated in the next section, are that:

- *Thorn* ignores the realities of today's construction industry; and
- *Thorn* does not ensure that risk goes with control.

Does *Thorn* ignore the realities of today's construction industry?

Principals undeniably have a better opportunity to collect information and review plans. A project may well be in development for a year or more before being put out to tender. By contrast, tenderers will often be given somewhere between one and two months³¹ to review the invitation to tender, liaise with subcontractors, price the

works and compile a tender. The timing is tight and it is understandable that contractors will often simply rely on information provided by the principal to make the timing work.³²

Similarly, principals' engineers will invariably have far more time to prepare a specification than prospective tenderers will have to prepare tenders. Principals' engineers also have the advantage of being engineers, whereas contractors are experts at building to a design.

The question becomes: why shouldn't principals – armed with the expertise, access to relevant information and time to prepare an adequate specification – be responsible for errors, inconsistencies, impossibilities and/or omissions in the material they provide to contractors? Or, possibly more importantly, why should contractors be saddled with that risk?

The simple answer is that contractors are still better placed to manage the risk of buildability.

Contractors are still better placed to manage the risk of buildability

Time and expertise

There is a disparity between the time available to principals (and their consultants) in developing a specification and the time allowed to contractors (and their subcontractors) in preparing a tender. It is also true that contractors cannot be expected to possess expertise in engineering. But those disparities will usually be of limited significance because:

- Contractors are not expected to develop the specification for an entire project. They are expected to examine a specification that has already been prepared, to determine whether or not to tender for the works and to work up a price for such a tender.
- That task is simplified by the fact that contractors do not come to each project fresh; they bring their experience with them. If the proffered project entails the same work and details as an earlier project, the contractor will know that it can be done and how much that work can be expected to cost.
- The disparity in expertise between engineers and contractors loses its significance where contractors have previous experience of

the kind of works proposed. There is no unfairness in treating a contractor as an expert in relation to the buildability of works it has successfully undertaken in the past.

- Moreover, the task of reviewing and pricing works is not left entirely to prospective tenderers. Instead, general contractors seek bids from subcontractors to undertake specialised packages of works – delegating portions of the task of pricing a project.
 - Further, consultation with subcontractors should arm contractors with specialist insights (necessarily focused on buildability) regarding a proposed specification. This will often negate the need for a contractor to engage their own engineering consultant, while providing them with a greater understanding of subcontracted packages than the principal's engineer would be able to provide.
 - Ultimately, the process of preparing a tender should involve either a practically experienced contractor or a specialist subcontractor considering each aspect of a proposed specification and:
 - allocating a price to the achievable;
 - tagging the unachievable; and
 - identifying any unknowns (ie, risks) to be managed by the contractor.
 - And, in fact, a review of some of the authorities canvassed here illustrates that this tends to be true. In *Thorn*, the use of caissons instead of coffer dams was unusual – issues arose because the contractor uncritically accepted that it could do what had not been done before. Similarly, in *Bentley*, the contractor had to see the risk inherent in a specification that had been amended on the fly in a post-tender meeting. In both cases, the risk was identifiable – it simply was not managed.
 - In addition to the fact that contractors and principals have relatively equal opportunities to identify buildability issues, it needs to be borne in mind that contractors and principals have different objectives. As Hudson observes, principals and their engineering consultants care about a design that meets the principals' needs (ideally as cheaply and as quickly as possible). Only contractors need to worry about actually building to that design.³³
- The upshot is that contractors are more likely to identify buildability and design issues. That is because attention is selective. The brain focuses on information relevant to the task it is performing and filters out distractions.³⁴

In a famous experiment, test subjects were asked to count the number of times a basketball was passed between players on a single team. While focusing on that task, a significant majority of the subjects failed to notice a gorilla moonwalking across the basketball court.

The fact of selective attention means that contractors and principals (and their respective advisers) will be looking for and seeing different things in a proposed specification. The fact that contractors' attention will be directed towards buildability also suggests that they are better placed to manage buildability risk.

In summary, contractors will usually be placed as well as, if not better than, any other party to identify buildability issues in a proposed design owing to their practical experience in construction, access to specialist expertise and particular focus on what is required to complete (and must be included in the price for) works that comply with the proposed specification. This is true notwithstanding time constraints and apparent disparities in specialist expertise.

The race to the bottom

Against that background, the fundamental point underpinning *Thorn* – that contractors have options for managing risk – remains potent. Where contractors are best placed to identify risk and have options to manage it, those options should be exercised. Specifically, when a contractor is asked to tender for a project that involves unknowns, that contractor will have at least four choices:³⁵

1. walk away;
2. ask for time to investigate those unknowns before submitting a tender;
3. agree to undertake the project, warts and all; and
4. identify those unknowns and
 - increase its price to reflect the risk it is assuming; or
 - tag and negotiate the allocation of risk for those unknowns.

In fact, the standard procurement process is designed to allow contractors to exercise those options through the use of tags. Tenderers are not typically required to bid for a project on a take-it-or-leave-it basis. Rather, they are entitled to 'tag' items that they are not willing to accept without further discussion or amendment. Closing out tags then becomes the objective in post-tender meetings between principals and preferred tenderers.

The over-use of tags is not advisable because heavy tagging often indicates high hidden costs or extensive conditions, both of which tend to deter principals. But the process should certainly be used to identify significant risks and promote an open discussion about risk allocation.

In particular, tenderers should be more willing to use this process to squarely address the allocation of risk for designs or strategies they have not encountered before and have no objective reasons to accept as viable.

Further, to the extent a tag cannot be closed out satisfactorily, tenderers should be prepared to walk away. The results of the recent Russell McVeagh survey on the causes of construction disputes indicate that contractors undervalue the utility of the tagging process (particularly as a defence against inadequate principal-supplied information).³⁶

None of this is to say that it will be easy to implement the culture change proposed above. The construction industry involves large projects with narrow margins. In the recent *Mainzeal v Yan* decision, the New Zealand High Court accepted that in 2012 'it was well known that the industry operated on very small margins'.³⁷ Now, as in 2012, participants in the industry must win work to survive; cashflow is the lifeblood of the construction industry.

The upshot is that neither walking away from a project nor making waves by asking for additional time will typically be an attractive option. The drive to secure work also makes contractors prone to the temptation to bid low and keep tags to a minimum.

Construction is a difficult industry and the pressure to win work is obvious, but simply caving to that pressure and accepting it as a fact of the industry means change will never occur. Taking the steps set out here may well mean losing work. Nevertheless, there needs to be a culture change. The existing 'race to the bottom' is not sustainable and has already started claiming casualties.

Pairing risk with control

It is uncontroversial that 'project risk should be allocated to the party best able to manage it'.³⁸ Both the *Spearin* doctrine and *Bacal* attempt to give effect to this first principle by allowing recovery on the basis of an implied warranty from a principal. However, each approach takes a very different view as to what kind of control warrants the implication of such a warranty.

SPEARIN – CONTROL OVER THE WORKS

The US concern, that risk should accompany control, can be dealt with shortly. While risk should be allocated to the party best placed to manage it, the *Spearin* doctrine does not actually achieve that. *Spearin* assigns the risk of buildability to the party with control over the works of a project, but by the time the project has been awarded, the opportunity to manage buildability risk has already been lost.

The party usually best placed to manage buildability risk is the prospective tenderer. The allocation of risk under *Thorn* reflects that fact; the allocation of risk under *Spearin* does not. Certainly, nothing prevented the contractor in *Bentley* from requiring an express warranty that the alarmingly revised design in that case would work – it had control at that earlier point, but chose not to exercise it.

The party usually best placed to manage buildability risk is the prospective tenderer

It follows that the US authorities (at least to the extent they can be explored within the limits of this article) do not provide a justification for New Zealand to depart from *Thorn*.

BACAL – CONTROL DURING TENDERING

There is a more compelling case for a departure from *Thorn* where, as in *Bacal*, the principal directs tenderers to make an assumption during the tendering process. Such directives appear to deprive tenderers of the opportunity to consider the risk inherent in the assumption and adjust their price against it.

But notwithstanding its real appeal, *Bacal* cannot be treated as an exception to *Thorn*. Among other considerations:

- as Taz points out, the Court of Appeal omitted a number of critical steps in its implication analysis (including an assessment of whether the parties would have agreed that the warranty ‘went without saying’ at the time of contract), making *Bacal* a dubious authority on its face;³⁹ and
- it is not clear the principal was actually directing tenderers to accept that borehole samples were accurate. The principal had no special knowledge of ground conditions and it is more likely they were asking all tenders to be made on the same bases to allow for an ‘apples-to-apples’ comparison of proposals. This underscores the difference in priorities (and consequent

difference in approach) between principals and contractors during tendering.

The process of implication is only intended to reveal an obvious, albeit unspoken, provision as part of a contractual arrangement. But it is difficult to think of a situation in which a principal would ‘obviously’ warrant buildability; they would have no incentive to do so and any indication of a warranty may be the result of miscommunication (as was likely the case in *Bacal*).

Taking that observation together with the fact that tenderers will usually be better placed than principals to identify buildability risks (and to assess how they can be reasonably managed), it is difficult to conclude that even a case like *Bacal* justifies the implication of a warranty from the principal.

The better approach would be for any tenderer that believes their prospective client is (exceptionally) offering a warranty of buildability to ask for express confirmation.

Conclusion and practical guidance

Contractors are usually best placed to identify buildability risks. A combination of practical experience and access to specialist knowledge (in the ordinary course of preparing a tender) means that such risks will typically be identifiable without any duplication of engineering work. Contractors are also best placed to raise and manage such risks by making use of the tagging process. Ultimately, they also have the ability to walk away if the risk profile of a project is unjustifiable. Control of buildability risks therefore lies with prospective tenderers.

It follows that retaining *Thorn* as a hard rule is for the best. In place of exceptions being allowed, contractors must be prepared to fight their corner (even if that means occasionally suffering the stress of going without new work).

In light of that conclusion, contractors would do well to bear the following in mind when tendering:

- with or without an ECI phase, contractors bear the risk of buildability; but
- that risk is manageable, particularly by:
 - drawing on past experience and the advice of specialist subcontractors;
 - understanding and pricing for acceptable risks;
 - tagging and negotiating the unprecedented; and
 - being prepared to walk away from unacceptable risks.

In short: builder, beware.

Notes

- 1 *Tharsis Sulphur and Copper Co v McElroy & Sons* (1878) 3 App Cas 1040, 1043–1044, 1052–1053; *Thorn v Mayor and Commonalty of London* (1876) 1 App Cas 120, 128, 132–133, 138.
- 2 *Laws of New Zealand Building and Construction: Performance* (online ed, <https://tinyurl.com/yc9zpzq>), 169; see n 1 above, *Thorn*, 131–133; see n 1 above, *Tharsis*, 1043–1044, 1053; *Wilkins and Davies Construction Co Ltd v Geraldine Borough* [1958] NZLR 985 (SC), 994, 996–997.
- 3 Julian Bailey, *Construction Law* (2nd ed, Informa Law 2016), Vol 1 para 3.154.
- 4 Nicholas Dennys and Robert Clay (eds), *Hudson's Building and Engineering Contracts* (13th ed, Sweet & Maxwell 2015), para 3-074.
- 5 *Ibid*, para 3-075.
- 6 *Thorn v Mayor and Commonalty of London* (1876) 1 App Cas 120 (HL).
- 7 *Ibid*, 131–132.
- 8 *Ibid*, 132.
- 9 *Ibid*, 133, per Lord Chelmsford.
- 10 *Ibid*, 131.
- 11 See n 1 above, *Tharsis*.
- 12 *Ibid*, 1043–1044, 1051–1052; see n 6 above, 132–133; *Jones v President and Scholars of St John's College* (1870) LR 6 QB 115, 127; *Hills v Sughrue* (1846) 15 M & W 253, 153 ER 844, 847.
- 13 See n 2 above, *Wilkins and Davies*, 997–998; see also *Slowe v Lodder* (1900) 20 NZLR 321 (CA), 366.
- 14 *Thomas v Amuri County Council* (1891) 9 NZLR 664; cf John Walton, 'Unforeseen ground conditions and allocation of risk' (2007), NZLJ 209, 210, which notes that the default allocation of risk under *Thorn* applies to both buildability and physical conditions.
- 15 See n 2 above, *Wilkins and Davies*, 994, 996.
- 16 Eg, *In Re an Arbitration between Carr and The Shire of Wodonga* [1925] VLR 238; *George Wimpey & Co Ltd v Territory Enterprises Pty Ltd* (1971) 45 ALJR 38; *Thiess Services Pty Ltd v Mirvac Queensland Pty Ltd* [2006] QCA 50, para 33.
- 17 *Codelfa Construction Pty Ltd v State Rail Authority (NSW)* (1982) 149 CLR 337, 355. It should be noted that Mason CJ nonetheless agreed that the principal in that case had not given an implied warranty of buildability, in particular because the relevant contract was not negotiated – contractors were simply left to take it or leave it.
- 18 *Morrison-Knudsen International v The Commonwealth* (1972) 46 ALJR 265, 267.
- 19 *Auto Concrete Curb Ltd v South Nation River Conservation Authority* (1992) 89 DLR (4th) 393. While the Supreme Court of Canada ultimately reversed *Auto Concrete*, both the court of first instance and Court of Appeal held that the risk of the contractor's unstated assumption (that it could employ the unlawful methodology on which its tender was based) should lie with the principal, because the contractor should not be expected to duplicate the work ostensibly already carried out by the principal's engineer.
- 20 *Edgeworth Construction Ltd v ND Lea And Associates Ltd* (1993) 3 SCR 206 (SCC), see the observations at para 18 in particular.
- 21 *United States v Spearin* (1918) 248 US 132, 135–136.
- 22 *Bentley v State* 73 Wis 416 (1889) 41 NW 338.
- 23 In the author's opinion, this should have set alarm bells ringing.
- 24 By the end of which, in the author's opinion, the alarm bells should have been deafening.
- 25 See n 22 above, 343. Also see the court's observation, at 344, that 'the state undertook to furnish suitable plans and specifications, and required the plaintiffs to conform thereto, and assumed control and supervision of the execution thereof, and thereby took the risk of their efficiency'.
- 26 *Ibid*, 344. The legitimacy of this distinction is discussed further below.
- 27 See n 21 above, 137.
- 28 *Bacal Construction (Midlands) Ltd v Northampton Development Corporation* [1978] 8 BLR 88 (EWCA).
- 29 *Ibid*, 96.
- 30 See Douglas Jones, 'Latent Site Conditions' (1986), 2 BCL 191, 208. The alternative view is that it reflects the concern that risk should go to principals (who are better placed to gather and check information) rather than to contractors (who often, as a practical matter, have to assume information provided is accurate). In that case, the evaluation of the Australian and Canadian concerns, set out in the following section, applies equally to *Bacal*.
- 31 Richard Wilkinson, 'Risky Business: Compiling a Tender Package' (2008) 24 BCL 377, 377.
- 32 *Ibid*; see n 18 above, 267; see n 14 above, John Walton; also see the feedback that 75 per cent of contractor survey respondents in New Zealand considered principal-supplied information to be one of the three main causes of construction disputes, reported in Russell McVeagh, 'Getting it right from the ground up – A survey on construction disputes: The causes and how to avoid them', 7, www.russellmcveagh.com/getmedia/d8e8376e-e7ae-42d5-9583-77219f3bc2e3/Russell-McVeagh-Construction-Disputes-Survey-Results.pdf accessed 14 March 2019.
- 33 See n 4 above, para 3-075.
- 34 Daniel J Simons and Christopher F Chabris, 'Gorillas in our midst: sustained inattention blindness for dynamic events' (1999) *Perception* 28 1059–1074.
- 35 Consistent with the options outlined in Lord Chelmsford's judgment in *Thorn*, see n 6 above, 133.
- 36 See n 32 above, Russell McVeagh, 7. In particular, compare principals' and contractors' responses in relation to issues with principal-supplied information and issues arising from not closing out tags.
- 37 *Mainzeal v Yan* [2019] NZHC 255, para 243.
- 38 Max Abrahamson, 'Risk Management' (1983) ICLR 241.
- 39 Deniz Taz, 'Encountering the unforeseen: Difficult ground conditions and the rights of a Contractor' (2012) 28 BCL 330, 337–339.

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Sunset in Seoul downtown. Credit: raker/Shutterstock

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Statutory liability for defects under Korean law

In the case of defects arising in construction works, employers usually have several options to remedy the defects or seek damages. Employers can seek to have defects remedied pursuant to defects liability provisions in their construction contracts or they can seek damages for non-conformance under the applicable contract law. Each method has its pros and cons.

Some laws will also provide for other avenues to seek compensation or remedy for defects. For example, many jurisdictions recognise the concept of decennial liability, which imposes a mandatory liability on contractors or architects (or both) for latent defects in constructed works. For instance, under the laws of Qatar, a contractor is liable to

remedy any latent structural defects for ten years after the completion and handover of a building. This obligation is mandatory in nature, such that it cannot be ousted or overridden by contractual terms to the contrary or by choosing a governing law other than Qatar.

The Korean Civil Act has 11 clauses for ‘contracts for work’ (comparable to the *Werkvertrag* under German law), six of which concern the contractor’s liability for defects (Articles 667–672 of the Civil Act). Unlike decennial liability, these provisions are not mandatory.

According to these provisions, in principle, the employer is entitled to demand repair of the works by a contractor or seek payment of damages in lieu of a repair claim (Article 667). This warranty claim can be, again in principle, exercised by the employer within five years or ten years, as the case may be, from the completion of the construction works (Article 671).¹

This paper discusses the applicability and scope of these statutory defect liability provisions, including the following questions:

- How does statutory defect liability under Korean law differ from contractual liability for non-performance?
- Do the statutory defect liability provisions under Korean law still apply in cases where there already exist contractual provisions on defect liability?
- Do these provisions apply if the governing law of a contract is not Korean law, but the subject construction works take place in Korea?²

Statutory defect liability under the Korean Civil Act

The basis for the statutory defect liability regime under the Civil Act is contained in its Articles 667 and 671. These provisions state as follows:

‘Article 667 (Contractor’s Liability for Warranty)

- (1) Where any defect is found in the completed subject-matter of a work or in a certain part of the subject-matter of a work which has been finished before the completion of all the work, the person who ordered the work may demand the contractor to repair and rectify such defect within a specified period: provided that this shall not apply if excessive costs are required for correcting a minor defect.

- (2) The person who has ordered the work may claim compensation in lieu of, or together with, correction of the defect.

- (3) Article 536 shall apply *mutatis mutandis* to paragraph (2).’

‘Article 671 (Contractor’s Liability for Warranty Special Rules Applicable to Land, Building, etc.)

- (1) A contractor for work with respect to land, a building or any other structure shall be liable for any defects in the subject-matter of the work or in its foundations for a period of five years after delivery: provided that this period shall be ten years where the subject-matter of the work is made of stone, limestone, brick, metal or any other similar material.
- (2) If the subject-matter is destroyed or damaged by reason of such defects mentioned in paragraph (1), the person who ordered the work shall exercise the rights mentioned in Article 667 within one year from the day that such destruction or damage took place.’

Under Article 667(1), statutory defect liability under Korean law not only applies to completed works but also to parts of the works that were finished before the completion of the entire works. As set out in Article 671, the defect liability period differs depending on the type of works under consideration. In the case of works related to land, buildings or any other structure, the statutory defect liability period extends for five years from the date of completion. However, where the subject matter of the work is made of stone, limestone, brick, metal or any other similar material, the period is ten years (Article 671(1)).

According to the Supreme Court,³ absent any special definition agreed by the parties, the term ‘defect’ under these provisions must be construed holistically. In this regard, a defect not only refers to noncompliance with contractual requirements, but also to situations where the completed works do not have the qualities ordinarily expected of such works in light of business norms and relevant regulations.

During this statutory defect liability period – five or ten years as the case may be – the employer is entitled to demand specific performance from the contractor to repair defects in the ordered works, except in such cases where the relevant defect is minor *and* the cost of repair would be excessive.

How statutory defect liability under Korean law differs from contractual liability for non-performance

The Civil Act includes the provisions on statutory defect liability in the section on contracts for works, which falls under the chapter on contracts. As such, the provisions on statutory defect liability are a part of Korean contract law as it relates specifically to contracts for works.

However, Korean contract law also contains some provisions that apply to all types of contracts. Article 390 of the Act forms part of these broader principles and states as follows: 'Article 390 (Non-performance of Obligations and Compensation for Damages)

If an obligor fails to effect performance in accordance with the tenor and purport of the obligation, the obligee may claim damages: provided that this shall not apply to where performance has become impossible and where this is not due to the obligor's intention or negligence [ie, fault].'

Similarly, pursuant to Article 389, a contractual

The Supreme Court has ruled that statutory defect liability provisions cannot be relied on by the employer to seek indirect or consequential damages

obligor can be compelled to specifically perform his obligations under a contract:

'Article 389 (Compulsory Performance of Obligation)

(1) If an obligor does not perform his obligation voluntarily, the obligee may apply to a court for compulsory performance thereof: provided that this shall not apply to where the nature of an obligation does not so permit.'

The question then arises as to how the provisions on statutory defect liability differ from a claim for damages due to a breach of contract.

The principal difference has to do with the standard applicable to establishing breach by reason of non-performance. Under Articles 389 and 390, the failure to perform must be 'voluntary' (Article 389(1)) or it must be due to the 'obligor's intention or negligence [ie, fault]' (Article 390). This effectively means that in order to establish a failure to perform for the purpose of these provisions, the employer would need to establish fault by the contractor (as is the case in many civil law jurisdictions). However, statutory defect

liability under Articles 667 and 671 of the Civil Act imposes a strict liability obligation on the contractor in that the employer does not need to establish the contractor's fault to make a claim. It would be up to the contractor to establish that the employer is not entitled to a repair claim because the defect occurred due to material supplied by the employer or due to an instruction given by the employer (Article 669). Even in cases where the contractor can establish this, the defence will not apply if the contractor, knowing the impropriety of the materials or instructions, has failed to notify the person who ordered the work (proviso to Article 669).

However, since statutory defects liability only relates to the repair of defects and the recovery of direct damages in lieu of such repair, the Supreme Court has ruled that statutory defect liability provisions cannot be relied on by the employer to seek indirect or consequential damages (or 'special damages' if using Korean law terminology) against the contractor, even where the circumstances leading to such indirect damages were foreseeable by the contractor.⁴ To recover its special damages, the employer would need to make a claim under Article 390 of the Civil Act by establishing that the damages arose due to a failure of performance that was attributable to the contractor's fault and, further, that the special circumstances giving rise to these damages were foreseeable by the contractor (Article 393(2) of the Civil Act).

Since the causes of action for a statutory defects liability claim and a claim for failure of performance are considered to be separate under Korean law, both claims can be pursued concurrently. This also means that claims for non-performance (ie, breach of contract) will not be subject to the periods applicable to statutory defect liability claims; instead they will be subject to the limitation period for contract claims in general (ten years) or the limitation period for claims relating to commercial matters (five years).

Statutory defect liability provisions in cases where there already exist contractual provisions on defect liability

The provisions on statutory defect liability under the Civil Act are deemed non-mandatory under Korean law. This means that the parties may agree to opt out or deviate from Articles 667 to 672 of the Civil Act. Thus,

the parties to a contract may agree to shorten the stipulated defect liability period. It is also likely that it would be possible to prolong the period of statutory defect liability.⁵ Parties may also agree in the contract on a different start date for the statutory defect liability period. Indeed, it is common industry practice in Korea that the parties agree for the statutory defect liability period to start from the date of governmental approval of the completed building (which can only be obtained following physical completion of the building) instead of the date of actual completion of the building.

There are, however, some circumstances where deviating from the statutory defect liability provisions might be considered to be invalid. Most pertinently, even if parties contractually agree to relieve a contractor of the obligations under the statutory defects liability provisions in the Civil Act, the contractor will still remain liable for defects that it failed to highlight at the time of completion despite being aware of them (Article 672 of the Civil Act).⁶ According to the Supreme Court, this provision also applies to cases where statutory defects liability period has not been waived but only shortened.⁷

In addition, there are provisions in certain other laws that can potentially result in invalidating an agreement to completely remove any type of statutory defects liability. For example, Article 22(5) of the Framework Act on the Construction Industry ('Framework Act') provides that where the terms of a contract are remarkably unfair to either party to the contract, such terms shall be deemed ineffective. In listing instances of such unfair terms, the provisions cite the situation

'where either party to the contract excludes or limits the right of other party to the contract acknowledged by related acts and subordinate statutes, such as the Civil Act, without good cause'.⁸

The effect of this provision with respect to the ouster of statutory defects liability is untested in the courts. However, parties should be cautious in removing a statutory defects obligation altogether from the contract.

Finally, while it is open to debate whether and when the Act on the Regulation of Terms and Conditions ('Terms and Conditions Act') applies to standard form construction contracts, to the extent that it might, Article 7(3) of the Terms and

Conditions Act states that where such a contract, without substantial reason, excludes or limits the warranty liability of a business person, the relevant provision shall be null and void. It should be noted, however, that contractual provisions that are individually negotiated and agreed will not be subject to Article 7 of the Terms and Conditions Act.

All in all, there are a number of circumstances under Korean law in which a contractual defect liability provision that extensively deviates from the provisions on statutory defects liability might be rendered ineffective or limited in scope.

Applicability of the statutory defect liability provisions in the Civil Act if the governing law of a contract is not Korean law but the subject construction works take place in Korea

The question of whether or not statutory defect liability provisions apply to projects that are not governed by Korean law, but are still situated in Korea, depends on whether these provisions are considered mandatory under Korean law. Article 7 of the Act on Private International Law states that

'irrespective of the applicable laws, the mandatory provisions of the Republic of Korea shall govern the corresponding legal relations even if foreign laws are designated as applicable laws thereof under this act'.

According to this provision (also known as

Parties should be cautious in removing a statutory defects obligation altogether from the contract

the public policy (*ordre public*) exception), a mandatory public policy provision under Korean law would still apply to a contract even if the contract itself is not governed by Korean law.

However, since the statutory defect liability provisions in the Civil Act are not mandatory in nature, they are unlikely to qualify as mandatory public policy provision within the meaning of Article 7 of the Act on Private International Law. Therefore, these provisions are only likely to apply in cases where the governing law of a contract is Korean law.

Concluding remarks

Statutory defect liability provisions under Korean law, while seemingly similar to decennial liability on the one hand or contractual warranties on the other, are actually distinct from contractual or mandatory defects liability. Their main advantage comes from the strict liability that they impose on contractors, in a jurisdiction where contractual breach is fault-based in general.

While Korean statutory defects liability provisions are not mandatory in nature, removing their effect entirely, as opposed to amending their duration or scope, may be invalid under Korean law, though this has yet to be tested before the courts.

Notes

* The authors wish to thank Yona Yoon (at Peter & Kim) for his contribution to this article.

1 For contracts of work that are not with respect to land, a building or any other structure, the time period is set under Art 670(1) as one year. Its relevance to construction contracts is, however, limited.

2 Under Art 28 of the Framework Act on the Construction Industry, a similar but not identical statutory defect liability regime is provided for contractors that are registered with the Korean government as construction companies under that act. While the details of that regime are not addressed in this article, it is worth noting that certain aspects of those provisions (such as their strict liability and

non-mandatory nature) remain the same as Arts 667 and 671 of the Civil Code.

3 Korean Supreme Court Case No 2008Da16851 dated 9 December 2010.

4 Korean Supreme Court Case No 2001Da70337 dated 20 August 2004.

5 Though there is no express provision or court precedent recognising that the parties may extend the period, a leading commentary notes that very old versions of the Civil Act specifically allowed prolonging the period. When the modern Civil Act was adopted, that provision was removed on the understanding that the right was self-evident; see Yong-Dam Kim (editor-in-chief), *Commentary to Civil Act (Law on Obligations, Particular Provisions IV)* (4th ed, Korean Association for Private Law, 2016), pp 366–368.

6 Art 672 of the Civil Act states as follows:

‘Article 672 (Special Agreement Releasing Warranty Liabilities)

Even where there was a special agreement between the parties that the contractor shall not be bound by warranty liabilities mentioned in Articles 667 and 668, he may not be relieved of liabilities with respect to the defects in workmanship or materials of which he was aware and nevertheless failed to give notice.’

7 Korean Supreme Court Case No 99Da19032 dated 21 September 1999.

8 Art 22(5), s 6 of the Framework Act.

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Rotterdam city view at sunset with construction cranes. Credit: Kiev.Victor/Shutterstock

Common law-style contracts in a civil law world

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The differences between common law and civil law are often highlighted and discussed from a civil law perspective, and more specifically a Dutch perspective. However, the term 'civil law' is too broad for a useful comparison with another legal system, as it covers so many jurisdictions that are not at all alike. What may be quite logical under Dutch law, for example, may be looked at quite differently in Chile or the United Arab Emirates, both civil law countries.

The one common denominator of civil law is the codification of core principles in legislation. Case law is most certainly of importance under civil law systems, but judges (and arbitrators) are basically required to apply (and interpret) the law. As for the law, it may vary quite considerably from one civil law country to another. That

being said, one generalisation may be made: in civil law jurisdictions legislation will provide a set of rules for most (if not all) situations that may be experienced in daily life. When it comes to business transactions, the law generally will provide arrangements to determine whether a contract was concluded between two parties and which

general conditions apply. If a dispute arises, the law arranges which courts to go to and which procedures to follow. And generally, if a particular case is not specifically dealt with in legislation, the law will still provide general principles and oblige contracting parties to behave in a reasonable and equitable manner in their dealings.

This article addresses the phenomenon that increasingly in the construction industry, common law-style contracts are used in civil law jurisdictions. By common law-style contracts, the author refers to contracts arranging in great detail any and all procedural and other issues related to a specific construction project (preferably written in English).

This article speaks from a Dutch perspective. When it comes to construction, Dutch law contains a set of provisions specifically related to contracting, as well as a number of provisions related to the assignment of work (eg, to architects and engineers). Both subjects are included in Book 7 of the Civil Code. The provisions on contracting are given in 20 articles (7:750–7:769 of the Civil Code) and those related to the assignment of work in 14 articles (7:400–7:413 of the Civil Code).

increasingly in the construction industry, common law-style contracts are used in civil law jurisdictions

The legal arrangements for contracting provide the highlights of what one would expect to be relevant for a construction project. There are arrangements concerning the price to be paid to the contractor and addressing several common situations, such as how to deal with an indicative price or how to deal with the situation when no price was agreed. The law provides a basic arrangement for how to deal with changes, as well as with circumstances that may necessitate a higher price to be paid. Naturally, the delivery of the works is dealt with, as well as the situation that the work might collapse before delivery. Defects in the works before and after delivery are equally dealt with, along with how a contract may be cancelled. And there are still other arrangements. The point is that in a relatively limited number of articles, a lot is taken care of. It is very important to note that these provisions are only specific arrangements for contracting, which relate to a whole underlying system that sets out

how commercial contracts should be dealt with. This system is embedded in the way in which commercial (and non-commercial) parties deal with each other. Parties know that there is always the law and the underpinning principles of the Dutch legal system of fairness and equitable behaviour.

When discussing legal questions and issues in an international context, one often has difficulty grasping what the problem seems to be, only to realise that the problem is dealt with in legislation in one's own jurisdiction. To be fair, such legislative solutions may be based upon a general approach and may not result in the best outcome for particular contracting parties in specific situations. That is precisely why contracting parties are to a great extent free to deviate from such solutions and to make their own arrangements.

That is where contracting comes in. A perfectly workable contract under Dutch law may consist of 20 to 30 pages, nowhere near the hundreds of pages that may be expected in common law-style contracts. The simple explanation for this is that a good contract under Dutch law should lay down the specific choices of the parties and leave the rest to the legal system already present.

Of course, in an international context, this may not be such a convenient system as most, if not all, Dutch legislation is written in the Dutch language. Although translations of the Civil Code are available on the internet, a translation may not provide a full and proper understanding of the underlying principles and regulations. The Civil Code is only one part of the legislation that may be relevant to the contracting parties. Furthermore, contract philosophies such as design, build, finance and maintain (DBFM), build–operate–transfer (BOT), build, own, operate and transfer (BOOT) and design and construct (D&C) generally originate from common law roots. As the popularity of such contracting philosophies rose, so did the use of rather extensive – common law-style – contracts. So these days, a lot of construction contracts in the Netherlands are either plain common law-style contracts, written in English or (Dutch) translations of such contracts.

The upshot of this trend is that contracts are easier to recognise internationally and do appear more familiar to parties from a common law background. In my opinion there is a (considerable) downside to this as well.

First, there is a language barrier. The contracts described are often drafted in English by non-native speakers. It is not uncommon that much boilerplate text is used, which is then copied from one project to another. Unsurprisingly, that does not necessarily lead to the best wording of contracts. Furthermore, it may lead to rather different interpretations of the same wording of a contract as the understanding of English legal terms by native speakers may differ considerably from that of a non-native speaker.

This is where the legal barrier comes in. If the wording of a contract is not entirely clear, interpretation may be necessary. Generally, construction contracts concerning projects in the Netherlands are contracted under Dutch law. This means that the interpretation of the contract will eventually have to be done through the application of Dutch law and legal principles. To avoid any such interpretation, contract drafters tend to include pages of definitions and contractual language. As aforementioned, often this drafting is copied and re-used for other projects that it was not originally written for, or it is used out of context. Instead of the initial intention of clarity and comprehensiveness, the outcome may be pages of language that is difficult to read and even more difficult to understand. Add again the language barrier between non-native speakers and native speakers and a need for interpretation may be born.

This is when the two legal cultures (civil law and common law) may meet in ways that surprise the contracting parties. One-sided contractual clauses, providing either the employer or the contractor with a preferred position, may turn out not to provide that party with the result it was aiming for. A simple example may be the (very common) contractual requirement that any and all change orders may only be issued in writing. Under Dutch law, such contractual provision may not be of much use to the employer if it is not applied consistently. If the contractor can show that the employer commonly issued oral change orders and paid for such orders

as well, the employer may subsequently be considered to have waived the contractual requirement. One might think that adding several other provisions to this rather simple requirement (eg, changes may only be ordered by the engineer after a written notification by the contractor within 14 days after the event that they relate to) would lead to a better outcome, but the opposite may be true. The reasoning of a Dutch judge or arbitrator under Dutch law may well be that if the employer clearly put a lot of contractual emphasis on change order procedures but then completely failed to apply such procedures, this would only further underline that the employer waived its rights under such provisions.

As stated repeatedly, the author can only (and even then, only modestly) speak for his own jurisdiction. It is equally stated that the common law/civil law denomination does not do justice to the underlying differences between legal traditions and cultures within those two groups. It is a rather risky business to cross the divide by incorporating contractual provisions and mechanisms originating from the 'other side'. When using civil law-style contracts in a common law context, the 'parachute' of the law will be missing and the outcome will probably be even worse than when using common law-style contracts in a civil law context. When using common law-style contracts in a civil law context, it is important to realise to what extent the law may or will take over at some point. And it is important to make sure that the drafting of contracts is done in such a way that ambiguities are avoided. Copying boilerplate wording from a different legal system in a different language just does not do the trick.

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Red sandstone in a construction site. Credit: B.Panupong/Shutterstock

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The ground risk under contracts and geotechnical baseline reports

This article explains the legal and contractual principles of baselining the ground conditions in a contract, supporting the idea that the incorporation of the GBR in the contract is a valid and effective instrument for risk allocation among the parties.

Introduction

The geotechnical baseline report (GBR) is a statement representing the ground conditions for which, when incorporated into the contract, the contractor assumes the risk and ought to provide for it in the contract price.

This paper seeks to demonstrate that the incorporation of ground baseline conditions

(GBC) into GBRs is an effective tool for the contractual management of ground risk in construction projects, producing clarity in pricing contracts and for dispute prevention. The topics that will be dealt with in this paper are:

- the legal basis of the allocation of ground risk;
- the general concept of GBRs;

- their place in the contract; and
- the contents and use of GBRs.

The allocation of ground risk: the legal basis

In some jurisdictions, such as France or Qatar, the latent geological risk is a joint and several responsibility of ‘all builders’, that is, the contractor, the engineer or architect and the designer, for a period of ten years.

In France, under Article 1792 of the Civil Code, the latent geological risk is a contractor’s risk or a joint and several responsibility of all builders.¹ Article 1792 implies a fitness of purpose liability, irrespective of whether the cause of the defect was foreseeable or not, with the exception of external causes (eg, force majeure). The question of foreseeability in the ground risk may arise under the doctrine of *imprévision* in Article 1195,² which states as follows:

‘Where a change of circumstances that was unforeseeable at the time of the contract’s conclusion renders performance exceedingly onerous for a party that had not accepted to assume such risk, the party may ask the other party to renegotiate the contract.’

In Italy, Article 1664 of the Civil Code requires the employer or owner to give the contractor fair compensation in the case of unforeseen geological difficulties that make the works substantially more expensive. According to Article 1669 of the Civil Code, in the case of the collapse or serious defects in the works, the contractor bears the responsibility for the ground risk³ also towards third parties, for example, the buyer of the defective building,⁴ with a limitation period of ten years. The responsibility is extended under the contract or in tort to all those involved in designing and building the defective works, that is, ‘all the builders’.⁵ The contractual responsibility is limited by Article 1225 of the Civil Code to those damages that were foreseeable. Ultimately, it is essential to determine whether the ground conditions that caused damage or substantial additional costs were foreseeable or not, extending such exemption of responsibility to cases in which the contractor did not foresee or could not have foreseen those circumstances.⁶

Under German law, the Civil Code⁷ allocates the ground risk to the employer. The court has clarified that: ‘The subsoil is provided by the employer and therefore the

the incorporation of GBC into GBRs is an effective tool for the contractual management of ground risk in construction projects

employer must bear the consequences of unforeseen problems in connection with its subsoil.’⁸ Thus the question of foreseeability is also determinant under German law, notwithstanding the allocation of the ground risk to the employer or owner.

Under English law, the contractor bears the risk of changed ground conditions, unless it is otherwise expressly provided for in the contract. In *Workshop Tarmacadam Co Ltd v Hannaby* (1995),⁹ the Court of Appeal refused the contractor’s claim for the additional costs associated with encountering rock harder than foreseen, saying that had the parties wished to make provision for the unforeseen circumstances, they would have done so in the contract.

The rationale of this common law principle lies in the contract since, where the contractor has undertaken to complete works and to comply with contract drawings and specifications, it is responsible for performing the promises, irrespective of unforeseen conditions, without entitlement to variations.

In *Thorn v London Corporation*,¹⁰ the contractor undertook to build a bridge in accordance with a given method of work based on caissons. When the contractor claimed that caissons were not buildable due to adverse ground conditions, the court dismissed the contractor’s allegation that there would be an implied warranty as to plans and specifications providing the use of caissons, as ‘although it was the engineer who suggested building those caissons, the builder promised he would’. The court upheld the principle of certainty of price and performance and, in the absence of any contract term regulating the change in ground conditions, the unforeseen change of method imposed by adverse physical conditions was held to be a contractor’s risk.

In *Bacal Construction (Midlands) Ltd v Northampton Development Corporation*,¹¹ the ground conditions proved to be different from those anticipated in the tender documents and the employer had prepared a report on ground conditions on which the tender price had to be based. That report

considered the presence of sand and clay, instead of 'tufa', a spongy material that required substantial redesign. The Court of Appeal held that where there is 'an implied term or warranty that the ground conditions would accord with the hypothesis upon which the contractors had been contracted' then the risk, under differing circumstances, should be borne by the employer. In short, 'whether or not a statement is intended to be binding as a warranty depends on the intentions of the parties'.¹²

the first question is what conditions are expressly or impliedly foreseen under the contract

If a report on ground conditions is not expressly incorporated in the contract, it is not considered a term of the contract on which rights and obligations are measurable by reference to it. Rather it 'would require an unambiguous wording to give rise to such a result' and 'it does not contain any statement sufficiently definite and unqualified to amount to a representation upon which [the parties] could reasonably have relied'.¹³ Under the circumstances, the stringent requirements of *Thorn* would apply to the contractor.

Therefore, if the foreseeable site conditions are not defined under the contract, together with provisions for changed conditions, the ground risk remains entirely up to the contractor. If the parties intend to allocate to the employer a component of that risk, then they must establish in the contract a clear boundary between the ground conditions foreseen and allowed for in the price and, by exclusion, those residual risks that are considered to be 'unforeseeable' and so belong to the employer. Therefore, the first question is what conditions are expressly or impliedly foreseen under the contract.

Since 'it is legitimate, and commercially desirable, that both parties should be able to measure the risk, and agree the price on the basis of the warranties which have been given and accepted',¹⁴ data and reports on ground conditions may be considered a term or a warranty when they are expressly incorporated in the contract, as long as there is no uncertain language, waiver or disclaimer.

In essence:

- the allocation of ground risk is determined by the terms of the contract, and 'the general law of jurisdiction';¹⁵

- in a contractually neutral situation, such as where there is no term on adverse ground condition and when there is no warranty by the employer, the risk of adverse ground conditions is borne by the contractor;¹⁶ and
- a clear, common understanding of the physical conditions on which the contract is based and of the liability for bearing the consequence of the ground risk is one of the incentives for risk management and the 'reduction of this uncertainty is achieved by contract documents that are explicitly drafted'.¹⁷

In order to divide and allocate the risk between the parties, the contract should state the conditions that are allowed for by the contractor and should be included in the contract price, providing a mechanism to manage ground-related changes.

A contractual instrument that has regard to the aforementioned elements and sets the baseline reference conditions to be allowed for in the contract is named the ground baseline report (GBR).¹⁸

The GBR: general concepts

A GBR is a single 'contract document containing measurable contractual descriptions of the geotechnical conditions to be anticipated [...] during construction'.¹⁹ In fact, a GBR should be included as a representation²⁰ and not be merely provided 'for information'.

The Joint Code of Practice for Risk Management of Tunnel Works (JCoP)²¹ defines ground baseline conditions (GBC) as follows:

'Definitive statements about [...] the ground [...] and groundwater together with geotechnical properties of the ground which serve as the basis for construction Contract tendering purposes and for subsequent application of the contract with respect to the conditions actually encountered during Tunnel Works.'

A similar definition is included in the Code of Practice for Risk Management of Tunnel Works (TCoP), prepared by the International Tunnelling Insurance Group in May 2012, which used the term of 'Ground Reference Conditions'²² as the contractual definition of 'what is assumed to be encountered', but is not a warranty that these conditions will be encountered.

These definitions provide the synthesis of the purposes of the GBR. This includes the site data to be considered and relied upon under the contract, a measure of the risks to be

included in the contract price, the watershed for risk allocation and the basic list of hazards to be considered for ground risk management. Then, the contractor does not need to be predictive and include further contingencies on ground risk in its price beyond the limit of the conditions defined in the contract baseline.

During construction, the baseline may be compared with actual conditions, in order to determine if and how much these circumstances are more unfavourable than expected and to evaluate the appropriate compensation, thus avoiding any waste of time and disputes. In underground works, such evaluation could include an adjustment formula based on the expected excavation method, geotechnical parameters and rate of progress, or could be based on any other practical mechanism of extending or decreasing the time for completion or the contract price.

The Construction Industry Research and Information Association (CIRIA)²³ rightly concludes that ‘however unexpected the ground conditions prove to be it is better to have a defined base for the tenders so that it is known where the incidence of the resulting cost will lie’.

A connected and derived purpose of the GBR is risk management during contract implementation. The GBR can be used by contractors as the basis to prepare the initial risk assessment and management plan as far as geotechnical conditions are concerned.²⁴ Such initial evaluation, if provided as a tender risk register, could be used by the employer as an evaluation tool in selecting the most convenient and compliant bidder from a risk point of view.²⁵

The management of risk should then be furthered beyond the range of contractually motivated reasons, but be comprehensive and subjected to periodic updating, revision and monitoring.

That said, it is emphasised that the GBR is not a measure for risk management during the construction phase, but the mere instrument for the allocation among the parties of contractual responsibility of the *residual* risk.

The GBR and its place in the contract

Anything can happen when dealing with ground conditions²⁶ and since contracts cannot specify all future eventualities, they should at least incorporate a contractual mechanism to determine how to deal with them. Furthermore, an undefined scope for ground conditions that are to be expected

under the contract is an open door to disputes, and the remedy is finding a way to define the parameters of what is or ought to be included in the contract price.

As such, those conditions should be considered as the basis or the baseline for risk evaluation and pricing. In fact, before executing a contract, the tenderer needs to know ‘with a sufficient degree of certainty’ the risk that it is going to price,²⁷ while the employer needs to know what it is going to pay for. Disclosure of the available site data by the employer falls in line with the principle that it has a duty to facilitate rather than prevent the proper performance of the contract.²⁸

In the United States, the application of the GBR was first recorded in 1972 in the Washington, DC Metro. In 1984, it became the subject of a study by the US National Committee on Tunnelling Technology, *Geotechnical Site Investigations for Underground Projects*.²⁹ In 1997, the American Society of Civil Engineers (ASCE) published the guidelines proposed by the Technical Committee on Geotechnical Reports of the Underground Technology Research Council and a revised version was issued in 2007.³⁰

Anything can happen when dealing with ground conditions

In the United Kingdom, the CIRIA published in 1978 its Report 79, *Tunnelling – improved contract practices*, which mentioned ‘Ground Reference Conditions’ (GRCs). This was the forerunner to the concept of the GBR, which appeared in 1997. The concept of GRCs was used in the original JCoP,³¹ which referred also to geotechnical baseline conditions.³² The name of *Ground Reference Conditions* was retained in the Code of Practice for Risk Management of Tunnel Works in 2012.

More reports were issued that emphasised the method of presenting site investigations and incorporating such documents into the contract in order to define the basis of tendering and then to measure what should be included in the contract price as ‘foreseeable’ conditions, and what should be priced as a variation or as an adjustment to the price.

Beyond the GBR, site investigations may result in other types of geotechnical reports:

- a geotechnical data report (GDR) is ‘all the factual geotechnical data collected

during geotechnical exploration' that does not include interpretative analysis. The guidelines in the ASCE's *Geotechnical Baseline Reports for Construction* (2007) recommend that a GDR should also be part of the contract documents to be used in case the GBR is ambiguous or silent on any matter. In the author's view, the GBR should be so clear as to leave no room for interpretation, without the help of other documents. In any case, the GBR should have priority.

- A geotechnical interpretative report is a written assessment of geotechnical data with an interpretation, generally prepared for the use of the designer.
- There is also the geotechnical design summary report, which explains the assumptions made by the project designer. However, the contractual baseline for bidding and for construction should be contained in a single report in order to avoid confusion with conflicting documents. It should be well identified as the geotechnical model that the parties should rely on under the contract.

The GBR should be so clear as to leave no room for interpretation

The GBR contains the baseline *contractual references* to establish conditions encountered during construction that are *materially more adverse*, onerous and time-consuming or may be considered as 'unforeseen'. Then, the contract should also include a 'differing site conditions clause' (DSC) that allocates the risk of such changed conditions to the employer.³³

When the GBR is included in the contract, becoming the contractually accepted interpretation of the data, it removes the uncertainty of interpretation from contracts such as the 1999 FIDIC Red and Yellow Book, where the contractor is responsible for interpreting the site information provided by the employer.³⁴

Sub-Clause 4.12 ('Unforeseeable Physical Conditions') of both contracts provides that: 'If and to the extent that the Contractor encounters physical conditions which are Unforeseeable, gives such a notice and suffers delays and/or incurs Cost due to these conditions, the Contractor shall be entitled [...] to

- (a) an extension of time for any such delay [...] and
- (b) payment of any such Cost'

Under Sub-Clause 1.1.6.8, 'unforeseeable' 'means not reasonably foreseeable by an experienced Contractor by the date of the submission of the Tender'. Therefore, the inclusion of the GBR among the contract documents would have an impact on Sub-Clause 1.1.6.8, defining what is unforeseeable. The GBR could include a procedural mechanism to assist the application of additional cost and extended time entitlements under Sub-Clause 20.1 ('Contractor's Claims') and 8.4 ('Extension of Time to Completion'), facilitating the comparison between expected and actual conditions.

Under the Red and Yellow Books, the GBR could be included in the contract as a particular condition of Sub-Clause 4.12 ('Unforeseeable Physical Conditions') or could become part of the definition of 'unforeseeable' under Sub-Clause 1.1.6.8. Then the contractual notion of foreseeability, which is broadly defined in FIDIC 1999 as circumstances 'reasonably foreseeable by an experienced contractor',³⁵ is then narrowed to what is stated in the GBR.

Sub-Clause 4.12 is a DSC, but does not automatically give rise to a variation unless the engineer, in order to overcome physical difficulties, gives an instruction that falls under the conditions listed in Sub-Clause 13.1 ('Right to Vary'), such as additional work or a change in the work method, for example, underground excavation with a different type of tunnel boring machine. To the extent that the contractor suffers a delay or incurs additional costs, Sub-Clause 4.12 entitles the contractor to an extension of time for the delay and compensation of additional costs incurred.

Under the FIDIC EPC/Turnkey Silver Book, Sub-Clause 4.12 excludes any adjustment of time or cost for unforeseen difficulties, 'except otherwise stated in the Contract'. Therefore, the GBR and the DSC could be included under Sub-Clause 4.12 as particular conditions, modifying the 'total responsibility' of the contractor, as in the following example:

'Provided if and to the extent that the Contractor encounters adverse physical conditions during the construction of the Works, the effects of which delays the time for completion foreseen in the contract, shall entitle an extension of time to the Contractor.'

While one of the FIDIC Golden Principles provides that the balance of risk and reward allocation should not be changed by the particular conditions, the inclusion of

the GBR in the Silver Book could provide a prudent rebalancing of the otherwise unlimited allocation of ground risk on the contractor that has limited financial and capital resources. Since the employer may be ‘faced with the project in difficulty and a bankrupt contractor’,³⁶ there is contractual wisdom in allocating the ground construction risk fairly among the parties.³⁷

Under the NEC3 contract, Sub-Clause 60.1 (12) defines a ‘compensation event’ as the case of physical conditions that

‘an experienced contractor would have judged at the Contract Date to have such a small chance of occurring that that it would have been unreasonable to for him to have allowed for them’.

The NEC3 approach is based on reasonable probability, but baselines would define with certainty what would be reasonable to have allowed for. The GBR could be included as part of the contract under ‘Option Z (Additional Conditions of Contract)’ and be designed to trigger a compensation event, to be measured as ‘the difference between the physical conditions encountered and those for which it would have been reasonable to have allowed’.³⁸

The JCT forms of contract do not include ground risk under the list of ‘relevant events’. Therefore, adverse ground conditions, if introduced by way of a special bespoke term, could be added as a 15th item of Sub-Clause 2.26 (‘Relevant Events’), or as a cause for changes under Sub-Clause 5.1 (‘Definition of Changes’).

Clause 12 of ICE Fifth Edition provides a mechanism for claiming additional costs and delays if the contractor encounters physical conditions that ‘could not reasonably have been foreseen by an experienced contractor’. This provision is conducive to the ad hoc introduction of the GBR in the contract, as a means of defining what is included in the price as foreseeable conditions.

The Project Partnering Contract (PPC) 2000, the Association of Consultant Architects standard form for a partnering contract, provides for a joint review of the site investigations³⁹ that could produce a jointly agreed baseline report. The PPC 2000 provides for the open-book inclusion of risk contingencies to the price framework.⁴⁰ Also the bidder’s assumptions should be made known in order to promote the culture of transparency among the parties and to provide a shared base to assess the contract price.

The duty of disclosing the available site data falls in line with the principle that the employer has a duty to facilitate the proper performance of the contract.⁴¹

The FIDIC Emerald Book, Conditions of Contract for Underground Works, issued in 2019, is a design-build contract, in which excavation and lining are carried out on the basis of measurement of actual quantities of work. Under the Emerald Book, the GBR is incorporated in the contract, together with a baseline schedule. ‘It sets out the allocation of risk between the Parties’ for subsurface conditions.⁴² The GBR is instrumental for time and cost adjustment according to actual circumstances, and the time for completion may increase or reduce if actual conditions are more adverse or more favourable than the baseline and the GBR. Time-related costs are also subject to adjustment, according to a baseline programme and the terms of the GBR. Sub-Clause 13.8.3 provides that foreseeable conditions may be adjusted by applying the production rates in the baseline schedule to the actual quantities of work.

The GBR should take a practical approach in defining the site conditions

Lastly, in case of unforeseeable physical conditions under Sub-Clause 4.12, time and cost may change according to the circumstances actually met.

Contents and use of GBRs

The use of GBRs must be associated with express contract provisions to deal with changed conditions or the parties will face an uncertain recourse to the governing law of the contract to resolve disputes, defeating the purpose of defining both what is considered ‘unforeseeable’ and the remedies available under the contract.

The GBR should take a practical approach in defining the site conditions. It should focus not only on the ground, but on the method of work. In tunnelling, this document could identify the expected geotechnical classification, the method of classification and the distribution of the types of rock classes along the tunnel profile. Then the GBR could distinguish the method of work envisaged in the contract to bring clarity to whether the changed site conditions lead the parties into a variation, avoiding situations

If the description of geotechnical conditions in the GBR contradicts the contract documents, there could be conflicting interpretations and disputes

such as that disputed in the English case *Bottoms v Lord Mayor of York*.

The contents of the GBR should be balanced and realistic, since ‘overly conservative baselines for items such as obstructions [...] can result in overly conservative and costly bids’.⁴³ Overcautiously drafted baselines may cause the contractor to bear the total responsibility of the ground risk, resulting in a higher bidding price and defeating the allocation purpose of the GBR. The contrary would also be deleterious, when an oversimplified baseline would absolve the contractor from otherwise foreseeable risks.

Another good reason to give a balanced position to the GBR is that of motivating each party to resolve the difficulties that eventuate during construction within their capability and in the interest of the project that should be completed in time and within budget.

The description should be detailed enough to encompass the range of conditions that may occur. On the other hand, a vague or broad description of ground conditions would not eliminate uncertainties on risk allocation, but, after any event, it would leave room for its interpretation with inevitable hindsight knowledge. This would create fertile ground for denial of responsibility and disputes, especially when there is an expensive bill to pay as a consequence of adverse ground conditions. Therefore, baselines and DSCs should be ‘most clearly and unambiguously expressed’.⁴⁴ Another controversial point is when the GBR includes terms that are related to performance, such as an advanced rate of excavation, because that may be ambiguous and lead to discussions. That said, the GBR should provide parameters based on the behaviour of the ground with respect to its excavation rather than merely geological references.

If the description of geotechnical conditions in the GBR contradicts the contract documents, there could be conflicting interpretations and disputes. For example, geotechnical investigations may include many reports that may be difficult to integrate in a single interpretative work. Moreover, bills of quantities (BoQ) could also be confused with a baseline. However,

under some forms of contracts, substantial changes could entitle the parties to renegotiate time and rates. Lastly, the difference between BoQ and the GBR is that the former represents the quantities of the works and the latter describes its physical conditions⁴⁵ and both are unrelated to each other. This is the very reason for putting the common seal to a single GBR, warranted and relied upon by the parties where the GBR should have the highest priority among the contract documents.

Above all, since the GBR is the formal representation of the ground conditions on which the contract price is founded, it should not be manipulated in any direction, to avoid allegations of misstatement or misrepresentation.

It is difficult to prepare an appropriate GBR linked with DSC that defines in clear terms those circumstances that ought to be foreseen and provide a practical mechanism to measure differences. A potential weakness of the GBR lies in this point.

As there was a perceived reluctance on the part of clients/promoters to prepare GRCs, the JCoP (2003) that was then being drafted included the following provision:

‘7.2.5 Contract Documentation (as well as subcontract documentation for Tunnel Works as appropriate) shall include Ground Reference Conditions or Geotechnical Baseline Conditions prepared by the Client (or prepared on his behalf) or *shall require each tenderer to submit with their tender their own assessment of Ground Reference Conditions or Geotechnical Baseline Conditions* [emphasis author’s own].’

‘7.2.10 Notwithstanding the issue of a project Risk Register in the contract documentation, tenderers are required to prepare and submit their own project Risk Register for submission with a tender as well as specific Risk Assessments... with descriptions of risk mitigation/control/contingency measures.’

The reason for requesting ground baseline conditions and/or a risk register from tenderers is to make sure that the ground risk is properly assessed by the tenderer and included in the tender price so as to provide a level field for comparing bids. The contractual value of these submissions depends on the provisions of the contract that will eventually be signed by the parties. Even if in turnkey contracts the ‘contractor takes all the risk’, employers should be mindful that if the project encounters

ground difficulties, the employer will bear the consequences that may only be remedied by a monetary compensation.

For example, in *Obrascon v the Attorney General of Gibraltar*,⁴⁶ the contractor made a limited provision for polluted ground to be disposed out of the site, following non-binding information provided by the tender documents, and the judge said that he was not prepared 'to put precise figures on the actual and foreseeable quantities of contamination', but 'the contractor needed to make provision for a possible worst case scenario'. This risk could have been avoided if the quantities included in the bid would have been declared by the contractor and accepted by the employer, who at first suffered the delay and then had to face the risk of a dispute.

The GBR should include in clear terms the results of site investigations, but should also be drafted as a practical mechanism to measure actual conditions and compare them with those presented in the report.

In practical terms, the CIRIA⁴⁷ indicates that the reference conditions should include at least the following elements:

- a geological description of the site of the works, as well as the expected presence of gases, groundwater and contaminated ground;⁴⁸
- the method of construction;
- response to the behaviour of the ground during construction; and
- rate of advance, according to the geotechnical conditions.

It is impossible to predict with certainty what lies beneath the surface in any given position⁴⁹ unless the investigations are carried out on that very spot. This is the reason why ground conditions are best expressed in terms of characterisation and probability.

The GBR should take a practical approach to defining the site conditions; it should focus not only on the ground but also on the method of work. For instance, in tunnelling, this document could identify the expected geotechnical classification, the method of classification and the distribution of the types of rock classes along the tunnel profile. If the method of work is linked to the baseline conditions established in the contract, it becomes evident when changed site conditions lead the parties into a variation or a change dealt with under other terms of the contract.⁵⁰ The dichotomy between the claiming path of adverse physical conditions and that of variation was highlighted in the case *Maeda*

Corporation v Bauer Hong Kong [2019]⁵¹ where it was determined that either way required its own notice.

Conclusions

The GRC or GBR 'carries clear definition of risks and their allocations' and 'contains an effective means to settle disputes as risks materialise'.⁵² A properly drafted GBR integrates the contract bringing clearly defined terms of comparison (ie, expected versus actual) where the notion of foreseeability as the criterion for risk allocation could be hazy and become a potential subject of disputes.

As such, the GBR is an effective tool for the allocation of risk and the contractual management of differing ground conditions, provided that it is incorporated in the contract as a warranty and without unreasonable disclaimers. Since GBRs are not yet sufficiently utilised their use should be promoted by documents such as the TCoP and through their incorporation in standard contracts, such as the FIDIC Emerald Book.

Notes

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1 Art 1792 of the French Civil Code cites: '*Tout constructeur d'un ouvrage*.' Art 711 of the Qatari Civil Code includes similar provisions. See also Ellis Baker and Michael Turrini, *The Underlying Problem: Negotiating the Ground Condition Issue*, (Society of Construction Law Paper No 181 2013), p 4.

2 Ordonnance No 2016-131 of 10 February 2016, enforceable in contracts concluded after 1 January 2016.

3 Sentence Cass No 26552/2017 of 9 November: 'In order to be exempted from liability under Art. 1669 the builders [in Italian: *artefici*] must consider in the design of the building all the conditions of the ground in accordance with professional skill and current technical standards [...] that may affect the building during its design and construction.'

4 Sentence Cass No 27250/2017 of 16 November.

5 Sentence Cass No 17874/2013 of 23 July.

6 Monika Chao-Duivis et al (eds), *Studies in European Construction Law* (European Society of Construction Law 2015), p 449.

7 Civil Code (Bürgerliches Gesetzbuch or BGB), s 645 'Responsibility of the Employer' (Verantwortlichkeit des Bestellers) states that the contractor may request compensation:

'If the work has become obsolete, deteriorated or unworkable prior to acceptance due to a defect in the material supplied by the employer or as a result of an instruction given by the employer for execution, without any circumstance for which the contractor is responsible [emphasis author's own]'

- 8 Bundesgerichtshof IZR 60/14 of 28 January 2016.
- 9 *Workshop Tarmacadam Co Ltd v Hannaby* (1995) 66 Con LR 105 (CA), p 108.
- 10 (1876) 1 App Cas 120.
- 11 (1976) 8 BLR 88.
- 12 Max Abrahamson, *Engineering Law and the ICE Contracts* (4th ed, E & FN Spon 1979), p 58.
- 13 *Cooperative Insurance Society Ltd v Henry Boot* [2002] EWHC 1270 (TCC); Const LJ 2003, 19(2).
- 14 *E A Grimstead & Son Ltd v Francis Patrick McGarrigan* [1999] EWCA Civ 3029.
- 15 See n 1 above, Baker and Turrini, p 14.
- 16 *Ibid.*
- 17 Construction Industry Research and Information Association (CIRIA), *Tunnelling, Improved Contract Practice, Report 79* (London, 1978), p 12.
- 18 In the Code of Practice for Risk Management of Tunnel Works (TCoP) (International Tunnelling Insurance Group, 2012), that document is named 'Ground Reference Conditions' (s 7.2.5, p 12).
- 19 Darren Page, *Geotechnical Baseline Report*, Presentation, Engineering Group of Geological Society, 15 September 2009.
- 20 A representation in this context is a statement of facts made by one party to the other before entering a contract, on which the latter may rely in preparing work methods and pricing.
- 21 The Joint Code of Practice for Risk Management of Tunnel Work in the UK (JCoP), prepared jointly by the British Tunnelling Society and the Association of British Insurers, September 2003, p 15.
- 22 Also the CIRIA in *Report 79* at s 1.7 uses the term: 'Ground Reference Conditions'.
- 23 *Ibid.*, p 10.
- 24 'The Risk Register and GBR are complementary', as stated by Randall Essex, *Geotechnical Baseline Reports for Construction: Suggested Guidelines* (American Society Civil Engineers 2007), p 57.
- 25 TCoP, s 7.5.1, p 13:
'This Tender Risk Register should demonstrate how the tender submission adequately and appropriately caters for risks identified and to be allocated to the Contractor including their management and control procedures, proposed contingency measures and the cost and programme implications of the implementation of contingency measures.'
- 26 See n 12 above, p 66.
- 27 John Barber, 'Risk in the Method of Construction' in John Uff and Phillip Capper (eds), *Construction Contract Policy*, (Centre of Construction Law and Management, King's College London 1989), p 64.
- 28 National Research Council, *Geotechnical Site Investigations for Underground Projects* (National Academies Press 1984), p 19.
- 29 *Ibid.*
- 30 See n 24 above, Essex.
- 31 See n 21 above.
- 32 *Ibid.*, s 7.2.5.
- 33 See n 24 above, Essex, p 2.
- 34 Under Sub-Clause 4.10 [*Site Data*], FIDIC 1999.
- 35 Sub-Clause 1.1.6.8: 'Unforeseeable means not reasonably foreseeable by an experienced contractor by the date for submission of the tender.' This definition has not substantially changed in FIDIC Second Edition 2017.
- 36 See n 17 above, p 20.
- 37 See n 24 above, Essex, p 46.
- 38 Sub-Clause 60.1 (13).
- 39 Sub-Clause 8.4 ('Surveys and Investigations').
- 40 Sub-Clause 12.9 ('Risk Contingencies').
- 41 See n 28 above, Vol 1, p 19.
- 42 Clause 1.1.51.
- 43 William Edgerton (ed), *Recommended Contract Practices for Underground Construction* (Society for Mining, Metallurgy, and Exploration, 2008), p 19.
- 44 *W&S Pollock & Co v McCrae* (1922) SC (HL) 192.
- 45 See n 24 above, Essex, p 54.
- 46 *Obrascon Huarte Lain SA v HM Attorney General of Gibraltar* [2015] EWCA Civ 712 at 94. The contract in this case was based on the 1999 FIDIC Yellow Book.
- 47 See n 17 above, p 21.
- 48 See also TCoP, s 8.3.3, p 14.
- 49 In *Ove Arup v Mirant Asia-Pacific Construction Ltd* [2005] ABC LR 12/21 at 91, May LJ stated that a 'perfect and complete knowledge of the ground may be impossible to achieve'. Also see Julian Bailey, *What Lies Beneath: Site Conditions and Contract Risk*, (Society of Construction Law 2007).
- 50 See, eg, Sub-Clause 4.12 of FIDIC.
- 51 [2019] HKCFI 916; HCCT 4/2018 (9 April 2019).
- 52 Henry Tang, *Construct for Excellence: Report of the Construction Industry Review Committee* (2001), p 79.

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Rebus sic stantibus clauses in recent Polish case law

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The Polish Civil Code contains two *rebus sic stantibus* clauses. The first is a general clause that applies to all contracts. The second is specific and applies to construction works contracts with lump sum remuneration. These clauses make it possible for a court to increase the contractor's remuneration if certain prerequisites are met. For several years now, Polish common courts have increasingly upheld demands based on these clauses for an increase in the remuneration of contractors. The judgments give interesting examples of how prerequisites such as an extraordinary change of circumstances or a serious loss on the contractor's part are interpreted in the realities of the modern construction market in the European Union.

A general *rebus sic stantibus* clause is set out in Article 357.1 of the Polish Civil Code. According to this article, the court, on the request of one of the parties to a contract, may change the manner in which the contract is performed, the value of the

performance or terminate the contract. The prerequisite for the court interfering in this manner is to demonstrate that each of the following conditions is met: (1) an extraordinary change of circumstances; (2) serious difficulty in performing the contract

or threat of serious loss; (3) a causal link between (1) and (2); and (4) the parties' failure to foresee the impact of the change of circumstances on contract performance when concluding the contract. In making its judgment, the court should take into account the interests of all the parties to the contract and the principles of social coexistence.

A more specific *rebus sic stantibus* clause is set out in Article 632, section 2 (Article 632) of the Civil Code, which applies to specific work contracts and construction works contracts providing for lump sum remuneration.¹ According to Article 632, the court, on the request of a construction works contractor, may increase the lump sum remuneration or terminate the contract, provided that the contractor can prove that each of the following prerequisites is met: (1) a change in circumstances; (2) the change in circumstances could not have been foreseen; and (3) threat of serious loss to the contractor. Article 632, unlike Article 357.1, does not require the change in circumstances to be of an extraordinary nature.

An extraordinary change of circumstances could, for example, be a sharp rise in prices

It is accepted that Article 632 is a special provision vis-à-vis Article 357.1.² This means that a construction works contractor performing under a lump sum remuneration contract should generally base its claims on Article 632. However, due to the specific remuneration systems on the market (eg, remuneration based on the actual quantity of works at a fixed unit price), the court may in practice assess a given case based on both the general and the specific *rebus sic stantibus* clauses.³

Change of circumstances

An extraordinary change of circumstances within the meaning of Article 357.1 is presumed to be an unusual, uncommon, usually rare condition. Apart from the rather obvious cases of natural disasters, wars or regime changes, it is accepted that an extraordinary change of circumstances may also occur within the framework of stable economic development and be the result of a sequence of events⁴ (ie, rather than a single, catastrophic event). As explained above, the change in circumstances need not be 'extraordinary' for the purposes of Article 632. The view taken in case law is

that an event in the form of an 'extraordinary change of circumstances' should contain more elements of uniqueness than a 'change in circumstances' within the meaning of Article 632.⁵

An extraordinary change of circumstances could, for example, be a sharp rise in prices. In a judgment of 4 July 2016 (based on both Article 357.1 and Article 632), the Court of Appeal in Warsaw found that, with respect to a contract performed in 2009–2012 for the construction of a motorway, a rise in fuel prices of several dozen per cent (unprecedented when compared to fuel price rises from 2000–2008) and a rise in asphalt prices of several dozen per cent (considered extreme, though not unprecedented) constituted an extraordinary change in circumstances within the meaning of Article 357.1.⁶ Moreover, in the same case, the Court held that a rise in material prices during performance of the contract of 16 per cent above the rate of inflation and the pace of this rise could demonstrate a significant change of circumstances within the meaning of Article 632.

Similar parameters were also referred to by the Supreme Court in a judgment of 29 October 2015 (based on Article 632),⁷ assuming that the scale of the increases (23.87 per cent, including inflation regarding construction materials of 7.8 per cent and a price rise of 16 per cent above inflation), the scope of the price increase in question (the vast majority of construction materials due to the boom on the construction market) and the pace of the price increase could, objectively speaking, demonstrate a significant change of circumstances.

In the case of a contract for the construction of residential buildings, in a judgment of 27 November 2017 (based on Article 632), the Court of Appeal in Warsaw found that a sharp rise in the price of construction materials and services after a ten-year stabilisation period may be considered a significant change in circumstances (eg, when in 2007 the prices of materials rose by 42.4 per cent).⁸

In the case of another contract for the construction of an expressway (concluded in 2009), the Court of Appeal in Warsaw, applying Article 357.1, examined a situation in which, in the three years before the contract was concluded, there was a measured, steady increase in asphalt prices at the level of two to five per cent a year.

During the contract implementation, there was a war in Libya and the United States dollar strengthened sharply against the Polish zloty. As a result, there were sudden changes in crude oil prices (an increase of more than 143 per cent in the period 2009–2012), which in turn led to a rise in asphalt prices of 17–18 per cent a year. This situation was also deemed by the Court in its judgment of 6 November 2017 to be an extraordinary change of circumstances.⁹

In turn, in a judgment of 27 April 2018, the Regional Court in Warsaw found that the average price of diesel oil in the period when the contractor and its subcontractors were purchasing fuel (2010–2012) had risen by 40 per cent over the prices from the date the contractor submitted its bid, while asphalt prices had risen twice as fast as in the seven years preceding the period in which the contractor prepared its bid (the rise in asphalt prices from 2009 was ten per cent after two years and 33 per cent after three years). In the Court's view, these circumstances confirmed an extraordinary change of circumstances within the meaning of Article 357.1.¹⁰

A Supreme Court judgment of 8 March 2018 stands out against these judgments. In its judgment, the Court assumed that a change of circumstances may also be an individual circumstance, concerning a specific construction project only. In this case, it was a matter of covering the costs of additional earthworks required to complete the basic scope of the contract, the value of which amounted to 50 per cent of the remuneration for the basic scope of the contract. The construction works contract was a lump sum contract and contained provisions that transferred to the contractor the risk and cost of performing additional earthworks required to build a facility within the parameters indicated in the contract. Despite these contractual provisions, the Court held that, as the additional works could not have been foreseen at the time the contract was concluded, the fact that they were required constituted a change of circumstances within the meaning of Article 632 and justified the increase in the contractor's remuneration.¹¹

Serious loss and method of calculating increase in the contractor's remuneration

A serious loss is a loss that invalidates the original economic calculation of the contract parties, taking normal contractual risk into

account. It does not have to be a loss that threatens the contractor's financial standing, nor does it have to be a loss that puts the contractor in danger of insolvency. It is rather assumed that, when examining the rationale for applying the *rebus sic stantibus* clauses, the court analyses the transactional loss, that is, the loss under a specific contract¹² (though this is not a uniform view; the view also taken in case law is that, depending on the size of the contractor's business, the same loss may be serious for one contractor but not for another¹³). In any event, an analysis has to be made of the elements of the agreed remuneration and this analysis should be compared with elements such as profit, income and other elements in order to determine whether the loss actually arose, whether it was due to a change of circumstances or for other reasons, whether it was serious and how it could potentially be expressed in figures.¹⁴

Recent judgments show the evolution of the courts' approach to serious loss. For example, the Court of Appeal in Warsaw, in the aforementioned judgment of 4 July 2016 (based on both Article 357.1 and

Recent judgments show the evolution of the courts' approach to serious loss

Article 632), found that the concept of serious loss also includes the amount of lost profit. It is necessary to examine the whole situation, including the relationship between the agreed remuneration and the assumed expenditure and profit. However, the Court summed up these general guidelines by stating that, if the contractor proved that it had incurred a loss of 1.24 per cent of the contract value with an initially assumed profit of one per cent of the contract value, this would have to be considered equivalent to the contractor incurring a serious loss (the contract value in this case was approximately €150m).

This approach was developed by the Court of Appeal in Warsaw in the judgment of 6 November 2017 (based on Article 357.1), also aforementioned, where the Court held that, as the construction of express roads and motorways does not require above-average skills, the contractor expecting a profit of two to three per cent (ie, in this case approximately €1.5m) was reasonable and met competition requirements. As the cost of

asphalt assumed by the contractor when submitting the bid was approximately €4m and the actual cost of purchasing the asphalt was approximately €6.5m, its loss on the asphalt, after deducting transport costs and a margin for normal contractual risk, was approximately €2.2m. The Court reduced the loss calculated in this way by the profit expected by the contractor and awarded the difference (approximately €0.7m) to the contractor as an increase in its remuneration. The Court justified this calculation method by the fact that both parties were affected by an extraordinary change of circumstances and by the assumption that the *rebus sic stantibus* clause was not intended to ensure that the contractor would earn the profit initially assumed,¹⁵ but rather to protect the contractor from financing the project from its own funds.

remuneration for construction works can also be adjusted pursuant to the rebus sic stantibus clauses in relation to public contracts

A slightly different approach to serious loss and calculation of the increase in the contractor's remuneration was taken by the Court of Appeal in Warsaw in the judgment of 27 November 2017, where the Court found that the amount corresponding to the unexpected rise in materials prices should be reduced by the profit assumed by the contractor. Subsequently, only half the amount calculated in this manner should be awarded to the contractor as the amount due to it in connection with a change of circumstances, pursuant to Article 632. The Court found here that charging the entire loss calculated in this way to the owner would not be compliant with the principles of social coexistence. Interestingly, after a last-resort appeal by the contractor, the judgment was overturned by the Supreme Court in a judgment of 24 May 2019¹⁶ and the case was referred to the Court of Appeal for re-examination. In the judgment of 24 May 2019, the Supreme Court held that the application of the specific *rebus sic stantibus* clause (Article 632) would lead to such an increase in the contractor's remuneration that its loss would not be serious (not that the contractor would not incur any loss at all). In other words, the increase in the lump sum remuneration under Article 632 should

cover that part of the loss that exceeds normal contractual risk. The Supreme Court found that dividing the loss equally, as the Court of Appeal in Warsaw did in its judgment of 27 November 2017, was therefore incorrect. The Court of Appeal in Warsaw has not yet re-examined this case.

The aforementioned judgment of the Regional Court in Warsaw of 27 April 2018 is also worth analysing,¹⁷ as the Court pointed out that the contractor had incurred a significant loss on the whole of the construction works (not only on particular scopes of works affected by the change of circumstances). As the profits on other works did not compensate the contractor for the loss generated by the rise in fuel and asphalt costs caused by the significant change of circumstances, the unforeseen fuel and asphalt costs should be divided between the contractor and the owner. Consequently, the Court awarded the contractor half the amount of the unforeseen fuel and asphalt costs.

Other relevant issues

European and Polish public procurement law restricts the introduction of changes to public contracts. This fact was raised by investors subject to these restrictions as an argument against the application of *rebus sic stantibus* clauses to public contracts for construction works. However, this issue was settled in a number of judgments and it is now accepted that remuneration for construction works can also be adjusted pursuant to the *rebus sic stantibus* clauses in relation to public contracts.¹⁸

Polish investors using FIDIC contract terms often heavily amend their content. Common changes introduced by Special Conditions include deletion or modification of Sub-Clause 13.8 of the FIDIC Conditions of Contract for Plant and Design-Build (the FIDIC Yellow Book). This has been raised as an argument against the use of the *rebus sic stantibus* clauses under the Civil Code. However, this approach has been rejected in case law, where courts have accepted that elimination of this sub-clause could not be interpreted as a finding that Article 357.1 of the Civil Code did not apply.¹⁹

Notes

- 1 Supreme Court resolution of 29 September 2009, III CZP 41/09; Supreme Court judgment of 11 January 2017, IV CSK 109/16.

- 2 Supreme Court judgment of 29 March 2012, I CSK 333/11; Supreme Court judgment of 29 October 2015, I CSK 901/14.
- 3 Judgment of the Court of Appeal in Warsaw of 4 July 2016, VI ACa 569/15.
- 4 *Ibid*; judgment of the Regional Court in Warsaw of 27 April 2018, XXV C 1697/12.
- 5 Supreme Court judgment of 29 October 2015, I CSK 901/14; see n 3 above.
- 6 See n 3 above.
- 7 See n 5 above, Supreme Court judgment.
- 8 Judgment of the Court of Appeal in Warsaw of 27 November 2017, VII ACa 824/17.
- 9 Judgment of the Court of Appeal in Warsaw of 6 November 2017, VI ACa 1462/13.
- 10 See n 4 above, Regional Court.
- 11 Supreme Court judgment of 8 March 2018, II CSK 325/17.
- 12 Judgment of the Court of Appeal in Krakow of 25 May 2016, I ACa 179/16; see n 1 above, Supreme Court judgment; see n 9 above; see n 8 above; *ibid*.
- 13 Judgment of the Court of Appeal in Szczecin of 17 March 2016, I ACa 894/15; *ibid*, Court of Appeal in Krakow; see n 8 above.
- 14 Judgment of the Court of Appeal in Warsaw of 28 June 2016, VI ACa 268/15.
- 15 Cf, eg, Supreme Court judgment of 3 June 2015, V CSK 589/14; see n 13 above, Court of Appeal in Szczecin; Supreme Court order of 24 April 2019, I CSK 640/18.
- 16 Supreme Court judgment of 24 May 2019, I CSK 218/18.
- 17 See n 4 above, Regional Court.
- 18 See n 14 above; see n 3 above; see n 9 above; see n 4 above, Regional Court.
- 19 *Ibid*.

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The Application of Contracts in Developing Offshore Oil and Gas Projects

Philip Loots and Donald Charrett

Informa Law from Routledge (2019)

ISBN: 978-0-367-13552-2

362 pages

Reviewed by Jaclyn Masters



Those practising in the field of construction and engineering will undoubtedly be familiar with both Philip Loots and Donald Charrett. Together and individually, Loots and Charrett have published extensively and have a broad practice within these fields. *The Application of Contracts in Developing Offshore Oil and Gas Projects* follows in the steps of their existing works in its thorough coverage of the development of offshore oil and gas projects internationally. The text is both academically rigorous and grounded in key industry and legal frameworks. Like their earlier co-authored text, *Practical Guide to Engineering and Construction Contracts*, this newly released text has a very practical industry focus and is aimed at lawyers and construction professionals alike. This is an advanced text and will be most beneficial to those with a working knowledge of the industry, specifically the intricacies of offshore oil and gas projects.

The Application of Contracts in Developing Offshore Oil and Gas Projects is a practical guide with an emphasis on offshore oil and gas project development and the heightened risk profile these projects have when compared with onshore construction. The text reads like a practical glossary and comprehensive overview of some key risk and project issues at the various stages of an offshore oil and gas project. Structurally, the text examines projects from inception to decommissioning, with a practical focus at all stages. It is also worth noting that the advice in this text is supplemented by appendices. For example, to support the focus in Chapters 3 and 4 on feasibility studies, Appendix B includes a sample framework.

The earlier chapters focus on ensuring that readers understand important definitions and thematic concepts as well as

appreciate the key risks that typically arise on offshore oil and gas construction projects. There are helpful and targeted international examples and case studies, and the commercial and legal ramifications of project decisions are explored. For example, in Chapter 2, the authors use a United Kingdom case study on fraudulent misrepresentation of key project personnel. It serves as a timely reminder of the importance of representations made during a project tender phase about the personnel who will be involved in the project.

Subsequent chapters explore more specific areas spanning the life cycle of an offshore oil and gas construction project. For example, Chapter 5 focuses on contract strategy and addresses the common misconception that an engineering, procurement and construction (EPC) contract is of necessity a lump sum contract. It distinguishes between EPC and engineering, procurement and construction management, both in terms of issues like privity of contract, buildability, and the dispute resolution implications, with some focussed diagrams to demonstrate these issues.

Chapter 7 looks at the all-important choice of contract for oil and gas projects. As well as outlining a case for the use of standard forms, the authors illustrate some key ones used across the world in the industry. By the same token, they warn against the use of precedents based on the theory that no two offshore construction projects are the same. While this may be the case, what these projects do share is the most common single cause of project failure: inappropriate project organisation, including having the wrong people in key positions, with roles and responsibilities that are neither well defined nor understood. Chapter 15 explores this carefully and its

inclusion in the text is appropriate given the reiteration of the need for the key personnel to be well matched to the specific project, first articulated in earlier chapters.

Chapter 16, focusing on international contracting, is a chapter I think many working in this field will be particularly interested in given the tendency for oil and gas projects to have an international reach in some form because of scale and cost considerations. Much of the chapter helpfully consists of checklists regarding general considerations to be resolved, contract documentation, company issues, and other vital areas. A detailed case study of the Petrobras-36 project supports this.

Unsurprisingly for those working in offshore oil and gas construction, variations are described as being at the heart of most offshore disputes. Chapter 18 contains practical project management advice, for example, on the importance of documentary evidence and maintaining accurate records, data and contemporaneous communications. Intrinsically, this also reads as sage dispute avoidance and risk management advice.

Chapter 20, another topic likely to be anticipated by many working in this area, looks at the challenges in achieving successful megaprojects. This chapter focuses on just two of the issues that can be addressed to improve project outcomes: scoping and risk allocation. This reflects the focus given to these issues throughout the book, and in relation to projects of all sizes within the offshore construction oil and gas category.

While many of the chapters cover content that one would expect to find in a text of this nature, several stood out as unique, either structurally or in content. As an example, Chapter 12 looks at construction in a

practical setting. It uses an unspecified medium-to-large project as a working case study, in addition to the many international reported judgments discussed in the chapter.

Similarly, many chapters use a checklist approach, perhaps best demonstrated in Chapter 13, which walks through commissioning and start-up. The use of this list format will be particularly helpful to experienced professionals looking for a more nuanced and thematic engagement with project issues.

Chapter 14, which includes a sample insurance clause alongside the discussion of risk allocation and insurance, is another example of content that was particularly helpful.

In terms of unique content, Chapter 19 explores the interesting concept of economic duress in the context of construction contracts on large oil and gas projects, from an Anglo-Australian perspective. The authors outline the elements of the claim, with extensive case references. They also explore the practical application of the law. The final chapter closes with decommissioning, a natural end for a book on offshore oil and gas projects given the end of (productive) life. The processes involved are discussed by reference to the UK continental shelf.

Overall, this is a comprehensive and practical text, and the advanced focus will make it a valuable resource for legal and construction professionals working on offshore oil and gas construction projects internationally.

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The International Application of FIDIC Contracts: A Practical Guide (2019)

Edited by Donald Charrett

Routledge,

ISBN: 9780367142971

442 pages

Reviewed by Bill Barton



'A Practical Guide' is an understatement. Covering 18 countries, each almost a book in its own right, and with 442 pages, this is not bedtime reading.

It is said that this book is not intended to be a formal text on the use of FIDIC, but such is the comprehensive nature of the guidance and explanations within the opening chapters that it will undoubtedly be regarded as one of the definitive guides to what FIDIC is and how to use it.

Apart from some useful summaries as to the differences between the rainbow forms, there is a detailed consideration of the Golden Principles, upon which FIDIC is drafted. This helpfully sets the scene for all the subsequent chapters and should be read by all those who seek to draft or amend FIDIC in order to recognise and understand the importance of how and why it is drafted, with the division of risk and responsibility.

It is important when examining the underlying use of FIDIC under different jurisdictions that the user recognises the allocation of specific risks, duties and obligations and how these have evolved over a long period of time.

While this book is about jurisdiction differences and is not specifically aimed at lawyers, it carefully provides enough explanation and guidance to the reader to ensure that fundamental aspects such as the allocation of risk are clearly set out and defined.

Any user of FIDIC will benefit from a careful reading of the chapter on the preparation of Particular Conditions. It gives clear explanation and guidance as to the meaning of the standard provisions and concise assistance on what should and should not be

changed, depending on the contents of the General Conditions and governing law.

If there is a criticism of this section of the book, it is that it undoubtedly goes into more than superficial detail and in conjunction with the detailed tables and prodigious footnotes, there is a significant amount to take in, digest and absorb. This book is probably not suitable for a first-time user of FIDIC unless read and accompanied with a full unamended form of the required FIDIC contract and the time to read it.

The book is written in plain English and with a minimum of legal jargon, but these early chapters still pull no punches and there is no oversimplifying. However, for individuals and parties with either some experience of, or long-term exposure and use of FIDIC, there are some great tables that identify modifications which might be made, and then sections dealing with which are most likely to appear, as between governing laws, applicable laws and employer's performance.

As a consequence of this methodical and patient analysis of a standard FIDIC contract, its layout, context, intent and purpose, these early chapters provide sensible assistance in its use and how to complete and apply the contract. Thereafter, you are ready to dive into any one of the 18 country-specific chapters.

As is made clear, these are all, bar one signed up to the New York Convention.

Each country's section follows the same format and deals with a set of specific questions and issues. They cover the country's basic legal environment, the applicable law and guidance as to the changes required to adapt FIDIC and the special conditions required to account for jurisdictional differences on

common construction law issues such as gross negligence, loss of profit, termination, dispute resolution and variations. Thus, there is a strong cross-jurisdictional content.

Each section is authored by a solicitor or of counsel with extensive construction experience in the delivery of projects and dispute resolution using FIDIC. Most of the authors are also arbitrators, adjudicators and even judges, so are able to understand and apply the principles observed from a variety of very helpful aspects. One very helpful aspect of each section is an outline of which issues a court or arbitrator may construe differently to that which is outlined in the contract, whether due to local law or custom.

It is neither possible nor practical to review in detail all 18 sections, so purely from the personal perspective of the reviewer, a short comment on the Australian and Italian entries are set out below, by way of comparison.

The individual sections are perhaps not enough on their own to stand as comprehensive references as to the ways in which FIDIC will be interpreted and how it should be completed for each country.

However, there is more than enough detail to ensure competent contract administrators comprehend the scale of issues they must consider, and are able to raise these with their client and, as necessary, to employ legal expertise locally to advise in greater detail.

Mention must also be given to the wonderfully coherent and useful glossary. Once again it is comprehensive and includes not only English words but words from across the world – for example, the word ‘impervision’ from Romania.

While aimed at contract administrators and/or lawyers who are more familiar with the requirements and peculiarities of FIDIC and the application of FIDIC in a range of jurisdictions, any lawyer involved in the drafting and negotiation of a FIDIC contract should read and digest this book.

If you advise across multiple jurisdictions or have clients operating in different countries, then this book can be considered to be essential.

It is available in an electronic version as well as in hard copy.

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Australia is a common law country.	Italy is a civil law country.
Australia comprises six states and two territories.	The Italian civil code is one of the primary sources of law and is divided into six books, of which the fourth book regulates the general provisions of obligations of contracts (including construction agreements).
While judgments from other common law jurisdictions will in theory be followed, there are instances when the statutory frameworks existing within the six states has led to judgements being overruled by a relevant court.	There is general freedom to agree the law of the contract and there are no particular requirements of formality.
Unlike in the UK, statutory adjudication is confined to payment disputes.	However, there are safeguards such as double signing, which are advised in order to be compliant with Italian law.
This section has a very detailed and useful summary of the applicable legislation for each state and territory as it applies to some of the fundamental aspects of FIDIC contracts.	There are also, for example, peculiar requirements that operate in the event of insolvent termination.

Table 1: comparison between Australia and Italy

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It has really been invaluable.

Paul Marmor, Sherrards Solicitors LLP, London

Membership has allowed us to connect to peers in different jurisdictions, and so better serve our client's needs. Businesses are increasingly international, and so it is vital to have the ability to connect with others and maintain the growth of our firm.

Anne-Helene Le Trocquer, De Gaulle Fleurance & Associés, Paris

First, I would say that I have met wonderful people, and that's the most important thing. You also obtain work. It's not that you look for business – you look for people, for friendships and then the business follows.

Jonas Bergstein,
Bergstein, Montevideo



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Construction Law International

Guidelines for submission of articles and updates from around the world

Articles should be submitted to clint.submissions@int-bar.org.

Articles/features should normally fall in the range between 3,000 and 4,000 words.

The author's name will appear with title but without post-nominal letters etc. Please provide a very short description (<20 words), which should include the author's name, firm or organisation, city and email. For example: '[name] is a [role] at [firm] in [city] and can be contacted at [email].'

As this publication is aimed at busy lawyers, please provide a 50- to 100-word summary, which would serve as the 'standfirst' (or introductory paragraph). This summary could be written in the form of a question or could state a problem that the article then deals with, or could take the form of some bullet points. Article titles should be 5–10 words long.

Endnotes are to be used for citations only. Footnotes are not used in this publication.

We welcome any graphs or other visual illustrations, including photographs that enhance the article.

The Editorial Board cannot guarantee publication. All contributions may be subject to evaluation by the Editorial Board prior to publication.

Updates can be up to 1,500 words, and should address a recent (from the past six months) court decision or change in local law of relevance to construction projects.

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The eyeWitness mobile app; seeking justice for the worst international crimes

eyeWitness to Atrocities begins with a simple vision: a world where the perpetrators of the worst international crimes are held accountable for their actions. As an initiative of the **International Bar Association (IBA)**, with the support from **LexisNexis Legal & Professional**, the eyeWitness to Atrocities app provides a means of documenting human rights atrocities in a secure and verifiable way so that the material can be used as evidence in a court of law.

Every day, around the world, human rights defenders, investigators, journalists and ordinary citizens capture photos and video of atrocities committed by violent and oppressive states and groups. eyeWitness provides these individuals with a tool to increase the impact of the footage they collect by ensuring the images can be authenticated and, therefore, used in investigations or trials.

With the eyeWitness mobile app, users capture photos or videos with embedded metadata that shows where and when the image was taken and confirms that it has not been altered. The images and accompanying verification data are encrypted and stored in a secure gallery within the app. Users then submit this information directly to a storage database maintained by the eyeWitness organisation, creating a trusted chain of custody. Users retain the ability to share and upload copies of their now verifiable footage to social media or other outlets.

eyeWitness becomes an advocate for the relevant footage it receives, ensuring it is used to promote accountability for the atrocities filmed. An expert legal team analyses all footage received and identifies the appropriate authorities, including international, regional or national courts, to investigate further. eyeWitness also works closely with organisations already documenting such crimes to incorporate the app into existing workflows that seek accountability for these same crimes.

By offering a solution to the evidentiary challenges of mobile phone footage, the eyeWitness app empowers those courageous individuals who are capturing footage with the ability to use these the images to bring the perpetrators of serious international atrocity crimes to justice.

The eyeWitness to Atrocities app is available to download for free on Android smartphones. For more information, visit www.eyewitnessproject.org, follow @eyewitnessorg on Twitter or Facebook, or watch the eyeWitness YouTube channel.

