**Reading Assignments – Preparation**

The course aims at familiarizing students with the legal, regulatory and contractual aspects surrounding major global infrastructure projects with a focus on the industry sector, in particular energy and transport infrastructures such as power plants, wind parks, waste treatment facilities, chemical plants, city tramways or metro projects, railways signaling systems, or any other similar complex projects.

The course will review, among others:

* The notion of infrastructure projects (civil works versus engineering construction; new built versus renovation projects);
* The political, economic, financial and strategic relevance of infrastructure projects in a globalized economy;
* The main players and contractual parties to infrastructure projects (investors; developers, general contractors; subcontractors; banks; insurance companies; government bodies; certification agencies; etc.);
* The particularities emerging from the cross-border dimension of the projects (export control; customs clearance; currency fluctuations; international political instability; local project site environment; transport risks; localization rules; technology transfer requirements; etc.);
* International private and public law considerations when handling global infrastructure projects (conflict of laws; public order; mandatory rules; treaties impact; lex mercatoria);
* The tendering/bidding process for global infrastructure projects and the impact of public procurement rules;
* The different types of contract forms governing infrastructure projects (turnkey or equipment supply contract; lump-sum or costs + fee; contracts for works or sales contract; sui generis contracts);
* The specific projects characteristics impacting contract drafting: project duration, project frame, project cooperation, project conflict risks;
* Key contract clauses and negotiation techniques: general clauses, commercial clauses, financial clauses, liability clauses, governing law & settlement of disputes clauses, boiler plate provisions, negotiation strategy;
* The recourse to international contract forms and standards as benchmark or reference for global infrastructure projects (e.g. FIDIC contract conditions; MF1; NEC; Orgalime; etc.);
* The impact of project financing (including bonds & guarantees) and the consequences on the balance of legal and contractual risks between the parties;
* The organization of the nexus of contracts and interface/interaction between the various projects agreements: „back-to-back“ issues with subcontracts and flow-downs of main contract risks between projects agreements (e.g. cross-default and cross termination risks);
* The management and resolution of disputes: contract & claims management activities during projects execution, dispute review boards and other alternative dispute resolution mechanisms, court litigation & arbitration.

Cours 2 - Préparation

**1° The top 10 things you need to know about FIDIC**

1. What does FIDIC stand for ?

* Fédération internationale des Ingénieurs Conseils

1. History of FIDIC

* Founded in 1913 by :
  + Belgium
  + France
  + Switzerland

1. What does FIDIC do ?

* FIDIC is a global representative for the consulting engineering industry, promoting the business interests of firms supplying technology-based intellectual services for built and natural environments alike

1. What does the FIDIC Suite of contracts cover ?
   1. The Red Book
   2. The Pink book
   3. The Yellow book
   4. The Silver book : Conditions of Contract for EPC/Turnkey Projects
   5. The Orange book
   6. The Gold book
   7. The Green book
   8. Subconsultancy agreement
   9. The White book
   10. The Blue-Green book
   11. Conditions of subcontract
2. What are the most popular forms & the FIDIC approach to risk allocation ?

* The contract structure is generally the same:

General provisions (Clause 1)

The Employer, Employer’s Administration OR Engineer, Contractor, Nominated

Subcontractors OR Design (Clauses 2-5)

Staff and labour, Plant, materials and workmanship (Clauses 6-7)

Commencement, delays and suspension, Tests on completion, Employer’s taking

over, Defects Liability, Tests after completion (Clauses 8-11/12)

Measurement and Evaluation OR Variations and Adjustments, Contract Price and

Payment (Clauses 12-14)

Termination by Employer, Suspension and Termination by Contractor (Clauses 15- 16)

Risk and Responsibility (Clause 17)

Insurance (Clause 18)

Force Majeure (Clause 19)

Claims, Disputes and Arbitration (Clause 20)

1. Traps for the unwary : No.1 Commencement date

* Clause 8
  + In practice many contracts are negotiated with no tendering or with significant post tender negociations
    - FIDIC has introduced the requirement to reach agreement and then create a letter of tender and letter of acceptance priori to sgning the contract (somewhat naive) and it would be preferable to included these as agreed terms in the contract

1. Traps for the unwary : No.2 Notices : conditions precedent

* the most controversial innovation of the FIDIC 1999 Red book is not amplification or amendment to the extension of Time provisions but the requirement under clause 20.1 which is a condition precedent to any extension of time or cost
  + reference elsewhere in the contrat demonstrates that if the contractor is not compliant, he forfeits any entitlement to an extension of time or cost irrespective of relevant circumstances
  + contractors must ne alter to notices under 20.1

1. Traps for the unwary : No.3 Aplication of laws

* When using a FIDIC contract, parties must consider how (i) the chosen law of the contract and (ii) the local laws will affect the interpretation of the terms of the contract
  + Will there be a conflict between the contractual terms and the applicable law ?
    - Where necessary amendment should be made
  + Additionnally, the parties should consider the FIDIC clause relating to adjustments for changes in legislation

1. How do dispute resolution procedures work under FIDIC contracts ?

* Disputes can be adjudicated by referral to a Dispute adjudication board DAB.
* The DAB will comprise of one ot three members, the default position being three (Clause 20.2)
  + Each member nominated one DAB member for approval by the other party, parties and members agree on the appointement of the third member who will be chairman
  + The form of the DAB appointment is the General Conditions of Dispute Adjudication Agreement:
    - a tri partite agreement
  + DAB members can be replaced in some circumstances
  + What is the effet of a DAB decision: DAB decision is binding and must be compled with immediately until revised by amicable settlement or arbitration
    - Parties must give effect to it
    - If no notice of dissatisfaction is served it is final and binding
      * Unless settled amicably, any dispute in respect of which the DAB decision (if any) has not become final and binding shall be finally settled by international arbitration. The Rules of Arbitration of the International Chamber of Commerce (ICC Arbitration) applies, with the appointment of three arbitrators (clause 20.6).

**2° Turnkey contracts: concept, liabilities, claims**

1. **The concept and its practical applications**
2. Origin of the term and definitions

* According to the most widely accepted definition: a turnkey contract is one “under which the contractor is responsible for both design and construction of a facility” (AID Handbook)
  + However: sometimes one finds the term used for other types of arrangements
    - for instance designs prior to the contract

1. Components of a turnkey contract

* a turnkey contract requires the design of the facility by the contractor
  + possible to have some designs in a preliminary separate contract
  + normally: contractor deals with
    - the technology component
    - supplies, construction and erection :
      * even in the most restrictive definition of a turnkey contract, the contractors owes the construction of the complete facility ready to be operated
        + subcontractors possible

“nominated subcontractors”

* + purchasers of turnkey facilities normally require from the contractor at least some help in financing the project
  + also sometimes the contractor’s obligations include complete training programs
  + it has became increasingly frequent for purchasers of industrial facilities or even eployers to require from the contractor some involvement beyond completion of the work:
    - maintenance and repair services

1. Contractual arrangements

* a turnkey contract: generally accepted in the sense of the term provides for design and construction under the single responsibility of the contractor, or occasionally complete construction alone
  + Also idea of the “later date”: control or purchaser ask contractors to take a share in the equity
    - Hope that such a participation reinforce the commitment of the contractors

1. Contracts forms

* The only international model form for turnkey contracts known to me is UNIDO
* Domestic ones: JCT
* All other forms currently in international use are not made specifically for turnkey contracts
  + Ex: FIDIC
  + But these forms are occasionally used for turnkey contracts
    - Complications

1. **Applicable law**

* turnkey contracts often seek to regulare in great detail all issues which possibly might arise between the parties
  + therefore applicable law could appear of secondary importance
    - this issue is important for two reasons:
      * because of rules of public policy which remain unaffected by contractual provisions
      * and in all the other situations where the contract is incomplete or contradictory
  + When considering applicable law in the context of turnkey contracts, four different types of legal rules have to be distinguished

1. The law governing the contract

* determines the contractual rights and obligations of the parties, the interpretation of the contract and, subject to some reservations, its formation and validity
* Parties are free to choose the law governing their contractual obligations, subject to certain restriction resulting from rules of public policy
* Where the parties have failed to agree on the law applicable to the contract, this law has to be determined by reference to conflict rules
  + The criteria for determining the law applicable to a contract differ considerably from one system of conflicts to another
    - Some systems apply the law of the seat or residence of the party which owes the characteristic obligation
    - Others refer to the place where this obligation is performed
    - Proper law f the contract as a bundle of criteria, reference to the place where the contract has been entered into or direct application of the place of performance
  + Conflict rules may provide that one legal system is applied to all aspects of the contract or they may distinguish according to the type of obligation
* Also where the conflict rules designate only one legal system for the entire contract, it may be necessary to characterize the turnkey contract
  + Therefore, court of arbitral tribunal to which the dispute is submitted will automatically apply to the contract law applicable in the purchaser’s country
* In view of this uncertainty, some negotiators for contractors prefer to leave the issue unresolved in the contract rather than provoking at the time of the contract negotiations an argument on this issue which is likely to raise susceptibilities

1. Laws regulations and standards defining the works

* Reference to these laws is often found in the specifications
  + International Standard Organization
* These laws and regulations just as the standards required In the specifications define the quality of the works and thereby the contractors obligations
  + If a change of law and regulation occurs: sometimes the contracts require that the contractor takes steps which can reasonably be expected to make the works conform to modified regulatory requirements
  + If not: constructor may have an implied duty to this effect
    - Implying obviously payment for the modifications

1. Laws and regulations affecting the contractors’ activity

* Laws and regulations directly applicable to the contractor
  + working hours, employment conditions, labor relations,… custom duties, traffic regulations, taxation…
* Sometimes the constructor has to observe these laws where the works are performed, but such a provision is superfluous since the constructor has to observe these laws and regulations by the very fact of his activity in the country and irrespective of a contract provision to this effect
  + Change in these laws : not a contractual matter
    - However if change of laws in the country where the works are performed especially if the work is for that state
      * Often need to have a provision in the contract to this effect

1. Law applicable to the dispute settlement procedures

* Normally the law of the court or arbitration procedures at the place where the procedure takes place
  + Determined independently

1. **The parties respective obligations and liabilities**

* Since the contractor owes the supply of the complete installation
  + The allocation of responsibilities between the parties might appear simple and one might think the purchaser’s only obligation is to pay the price
  + In practice the limits between the parties’ respective obligations are less clearly drawn and on a number of occasions, responsibilities and liabilities may shift from one party to the other

1. Design

* In pple contractor’s responsibility: design is complete, sufficient and adequate, and assures that the facility meets the contractually required performance guarantees.
  + The contractor’s design obligation foms part of his general obligation to supply an installation which meets the required performance guarantees
* The situation is different where the purchaser required changes in design
  + Generally use of the employer’s design : normally exonerate the contractor from liability for resulting defects except if the applicable law stipulates a duty to warn

1. Suppliers and subcontractors

* in pple the contractor is fully liable to the purchaser for the proper performance also of those of hhis obligations for which he retains subcontractors and suppliers
* Contracts occasionally provide that guarantees and warrantees of subcontractors and suppliers have to be passed on to the purchaser
* A shift in liability may occur in case of nominated suppliers and subcontractors: ie those chosen by the purchaser and imposed upon the contractor
  + It can be admitted that the contractor still has a duty to warn
    - But beyond a certain point the contractor should have no liability for the choice of subcontractors and suppliers thus nominated but should be responsible only for the proper supervision of the execution by them
      * Not infrequent that contracts provide for a complete liability by the contractor even for nominated subcontractor, or that the contracts do not regulate the matter at all

1. Time for completion

* Meeting of the completion date (or the successive completion dates) : contractor’s principal obligation
  + However, where the construction program has become part of the contract, the purchaser may require the contractor adheres to this program:
    - Assures the purchaser that progress of the works is sufficient in order to meet the completion date
    - The purchaser’s own production program and the coordination of the contract works with other work may require a strict adherence by the contracto to his programme
  + Where for reasons outside his responsibility, the contractor is delayed, the contract normally entitles him to an extension of time

1. Performance guarantees

* Contractor’s obligation to meet these guarantees:
  + Where his failure to do so is due to defects in approved design or variations ordered by the purchaser, the contractor is not relieved of his obligation unless a exoneration has been agreed expressly or by implication
* A failure to meet contractual performance guarantees is often sanctioned by liquidated damages reflecting the degree by which the guarantees have been missed
  + Generally a function of the contract price
    - Upper limit is generally provided
* The performance guarantees undertaken by the contractor are based on certain assumptions with respect tp the qualify of raw materials used and the operating conditions such as climate, supply of utilities…
  + Quite difficult to determine whether and to what extent shortfall in the performances guarantees are due to such variations in raw materials and operating conditions and not to defects in the contractor’s design or construction

1. The site

* the choice of the site, access to it and frequently also availability of utilities during the construction period, normally are an obligation of the employer
  + Contractor has to specify the corresponding requirements
    - If not appropriate: difficult problems
      * Who is responsible for unforeseen ground conditions?
        + Since the site is provided by the purchaser, it would be fair and reasonable to hold the contractor only for those ground conditions: on the basis of a site inspection and the information provided to him: ground conditions could have been foreseen by an experienced contractor
      * Limitation of the contractor’s obligation all the more justified in case of contracts where the contractor is generally not a civil engineering specialist and can hardly be expected to take risks in this domain

1. Price and payments

* The price for turnkey works normally is a lump sum:
  + While it is conceivable to express prices in a turnkey contract in the form of unit prices or by cost reimbursement, such arrangements seem to be rare
* Nevertheless: not infrequent that turnkey lump sum contracts contain a list of unit prices or prices for certain parts or coponents of the works
  + Serve for the valuation of variations and possibly also for progress payments
* In case of lump sum turnkey contract, it is hardly possibly to fix progress payments by reference to measurement of quantities
  + Partial payments in these contracts normally are made on the basis of milestone such as dates of placing orders to suppliers, achievement of certain stages in the process of manufacturing, packing of equipment, shipment, arrival at site…
    - Partial payment do not necessarily express the exact value of the works executed at the time of payment
      * So partial payments cannot serve as a basis for valuation

1. Unforeseen or exterior events

* in traditional law of contract, the question of unforeseen events is considered as a cause to exempt the party affected by the event from liability for non performance
  + most force majeure clauses still are drafted accordingly
    - this approach does not deal with the costs resulting fro the parties from the occurrence of such events
* Under traditional force majeure clauses, the loss therefore lies where it falls;
  + A nber of modern contracts or contract forms proceed differently and allocate between the parties the risks of such unforeseen or exterior events
    - Under the corresponding clauses, the contractor is entitled to compensation for extra costs if certain risks materialize.
  + Variety of criteria used to allocate between the parties the costs caused by such events
    - But generally result of the parties bargains

1. **Claims**

* Whenever the implementation of a project differs from the parties expectations and agreements, either party or both tend to present claims
  + Contractor: for additional payment
  + Purchaser: price reduction
* Complexity, duration and difficulties of implementation,… almost inevitable that situation arise in which either side formulates claims
  + Quiproquo
  + But sometimes: formal claims and disputes
* Importance of the legal or contractual basis: often neglected
  + Grounds of entitlement have to be clearly identified:
    - 1stly, because if there are no grounds there are no claim
    - the grounds for entitlement also affect the nature of the claim, the form required for its presentation, the valuation and the period of limitation

1. Claims for a variation (or change) orders

* the employer or purchaser or his engineer or architect may require the contractor to perform works different from those described in the contract
  + “variation orders” English
  + “change orders” in American terminology
* normally the contract: limits for variation
  + but in many cases the contractor is obliged to give effect to request for a variation only if he has accepted it and agreed on a price
* where the contractor is obliged to give effect to variation orders, certain forms are required: writing form
  + letter in generam
  + but in the US: constructive change orders: situation in which the conduct of the architect or engineer in its nature amounts to a change order and has to be construed as such
    - variations orders are a unilateral right of the employer, architect or engineer
      * the contractor has no right to vary the work on his own
    - if the change is necessary, contractor proposes but no answer : tacit agreement
* where the variation requires the consent of the contractor and an agreement on the price, the valuation of the variation does not pose major legal problems
  + except if contractor asks for unreasonable financial terms
* the application of contract prices to the varied work implies that the contractor’s costs in performing the variation in principle are irrelevant and that he may be paid above or below his costs according to how he had calculated his prices
  + if after variation, the contract price become unsuitable, they have to be adjust as appropriate
* where the contract does not contain a schedule of prices applicable to the varied work, one first has to attempt to derive from the contract prices new prices for the variation

1. Escalation

* it is hardly possible for the contractor to control fully the escalation of his costs during performance
  + may attempt to estimate the expected escalation and to build this estimate into his prices or provide for an escalation of the original prices
* where the contract provides for escalation by reference to a formula, the price adjustment normally can be calculated without difficulty
  + provided the formula have been properly chosen and the various factors can be asserted without dispute
  + arisen of difficulties if formula are wrong and dispute on factors
* where the contract does not contain an escalation clause, the contractor nevertheless may have a claim for cost escalation
  + if delays occur which fall in the employer’s responsibility, the contractor may be entitled to compensation for the escalation due to this delay
* the valuation of this escalation claim depends on the ground of which the contractor is entitled to the claim
  + contractor will most of the time to show the costs

1. Compensation for breach of a contractual obligation or warranty

* the breaches most frequently invoked against the contractor relate to defects in the works or to delays in their completion
  + such a breach gives rises to a claim for damages by the employer
    - contractual law: employer has to repair all the losses of the employer, including the loss of use of installation and the loss of profit
    - however, most system of law provide for limitation to the scope of the losses which have to be repaired
      * remote damages/dommages indirects
* most of the losses suffered by an employer can be foreseen: so limitations are if little comfort to the contractor
  + contractor therefore frequently try to protect themselves either by excluding claims for certain types of losses of by the provision of liquidated damages: sometime both approaches are applied cumulatively
    - exclusion of certain types of losses generally is possible under the applicable law
* liquidated damages : often used: limited to a percentage of the price
* with respect to breaches by the employer, the obligations which have to be considered generally are of a greater variety than those which are relevant in claims against the contractor
* under the applicable law a failure of a party to peform a contractual obligation does not necessarily give a claim to the other party for breach of contract
* the issue frequently has to be solved on the basis of the applicable law: surprises for the contractor
  + date, statutory interest rate
* valuation of claims of brases : based on the losses suffered by the injured party and the contract may provide limits as to the losses which have to be compensated

1. Compensation for excepted risks

* contracts sometimes provide for an allocation of risk between the parties:
  + change in legislation, natural disasters, war…depending also on the country or region
  + the employer undertakes to indemnidy the contractor in case certain risks matzeialize, the contractor’s claim normally is limited to his additional costs
    - exclusion of compensation for loss of profit
* it is submitted that this limitation to addtionnal costs is justified even in the absence of an express contract provision to this effect
  + insure the contractor against certain risks

1. Claims for time extension

* certain events which entitle the contractor to additional payments also give him the right to an extension of the time for completion
  + it does not automatically imply additional payments: events outside the parties’ control

1. Valuation of some cost factors

* costs of delay are particularly difficult to value : more than comparing the schedule and the completion date
  + the contractor has to establish that in the absence of the event in question, the activity would have been performed to programme
  + once the contractor has established the delay for which he can claim compensation, he has to show the resulting costs
    - delay can be dramatic especially work can be done only at certain time of the year for instance
    - the costs come from the absence of activity of personnel, plants and other assets : non use
      * need to prove that impossible to use them somewhere else
    - also delays in critical activities normally increases the costs of the site installation
      * financing expenses and cost escalation
    - events for which the contractor can claim compensation, without creating a delay in the program, may have caused disruption in the contractor’s work and reduced the productivity of personnel and the plant
      * particularly difficult to establish
    - when evaluating the costs of disruption or loss of productivity, one can refer normally to the contractor’s operating costs for personnel and plant
    - where the claim can be valuated by reference to contract prices, overhads and profits are to be included at the rate provided by the contractor in the original make up of his prices
    - where the claim is based on breach of contract, the contractor is entitled to compensation for the loss as it actually occurred

**3° Turnkey contracting under the FIDIC Silver book: what do owners want? What do they get?**

Introduction

The thesis developed is that owners do not get the turnkey solution they want

* the turnkey solution is not as simple as it sounds :
  + inevitable complexities of large projects
  + decreased appetite of contractors in the global projects arena
* there is a shortfall between expectation and actuality in many of the FIDIC provisions:
  + the appearance of risk transfer to the contractor is not as complete as might be suggested by FIDIC’s use of the term turnkey to describe the Silver book

1. Turnkey contracting

* the idea behind the turnkey approach is “for the contractor to be given the job to engineer, procure and construct the required works and then, once ready for operations, to hand over the keys to the owner so that it may operate the facility”
  + Turnkey means a contract whereby the contractor provides whatever is necessary for a certain purpose
    - “Lump sum turnkey” or LSTK: the intended bargain :
      * responsibilities allocated to the contractor to deliver the project on time and to a required performance level
      * in return for payment of a fixed price
    - LSTK include contingency allowances
  + EPC: engineer, procure and construct
* A feature of the turnkey approach to contracting, including revenue generating facilities, is the requirement for the contractor to prove the reliability and performance of the plant and equipment
  + Critical importance for the project to be delivered
    - Within the time and cost constraints
    - But also so that it is capable of meeting its designed production and output levels

1. Projects have a large number of moving parts

* a turnkey contract will be but one part of the contractual framework and one component of the risk management arrangements and contractual framework used on large projects
  + The risk allocation depends on a certain number of factors
  + The turnkey contract is the means by which the risk is allocated
* **The key risk in any construction project is completion risk**:
  + Within the agreed lump sum price, or,
  + Within the agreed time scale program, or,
  + To the required performance quality

1. Impact of an over-heated market

* Document dated from October 2007: huge change in the market
  + “At the time of delivering this paper, it is probably no exaggeration to state that the global construction economy is overheating. Demand for construction goods and services is high, driven particularly by the industrialized growth of large economies in both the People’s Republic of China and in India”

1. A score sheet for the FIDIC Silver book

* Market practice is to amend the silver book to cater for issues which commonly arise in practice and to take account of the particular features of each project

1. Unforeseen ground conditions

* Generally: test of foreseeability
  + “The contract price shall not be adjusted to take account of any unforeseen difficulties or costs”
    - But in practice the provisions of the Silver book are commonly subject to heavy negotiations between the parties

1. Design liability

* The issue of design liability can play a major role in determining the extent to which the turnkey solution is deliverable
  + Contractor is required to take full responsibility for the entirety of the design works
    - Numerous disputes arise where there are changes in the design of the works following award of the contract
    - In practice the risk allocation is frequently changed
      * Depending on the market for instance

1. Handover, testing and commissioning

* in many cases, the owner does not want to wait to take over the plant only after the plant is tested, commissioned, performance tested and ready for start up
  + often the owner will be an experienced operator of the plant
    - the Silver book does not explicitely deal with the issue commonly encountered on many lrge projects: the need for provisions to reflect the pre completion control required by owners
      * testing always a risky enterprise
  + in practice the silver book terms will often be subject to amendment to allo the owner’s team to have control and commercial operation (but not responsibility) by providing expressly for such an apparent dichotomy

1. Force majeure

* if turnkey means allocation of risk to the contractor, clause 19 of the Fidic silver book (force majeure) leaves the door open for that risk to migrate back to the owner
  + 1) both the time and cost impacts of such an event are allocated to the owner
  + 2) also the silver book’s definition of what constitutes force majeure is wider than one might have expected given the supposed turnkey qualities of this form

1. Limitations of liability

* this clause (17.6) is in two parts:
  + 1st: consist of a mutual waiver and release by each party in favor of the other in respect of liability for any indirect or consequential loss, subject to exception
  + 2nd part of the clause comprises a financial cap on liability: the contract price

1. Extension of time

* The Silver book adopts the term “time for completion” allowing the flexibility to apply this to a series of milestones:
  + Silver book contains a mechanism for the extension of this time for completion

Conclusion

* Critics
* But in many respects the Silver book does what it says on the tin: the provisions dealing with undorseen ground conditions, responsibility of the owner’s design and the provisions as to the sufficiency of the contract price are all good devices that help assure the silver book a true turnkey contract
* However: there are undoubtedly a number of areas where the turnkey qualities of yje form can be improved by tighter drafting

Cours 3 - Préparation

* **The legal context and contractual schemes for global infrastructure projects**

**1° LE GOFF, Pierrick : Theory and practice of contracts for the Construction of industrial facilities in Germany: towards a lex mercatoria germanica?, RDAI 2004, p. 5.,** [**http://www.iblj.com/abstract.htm?lg=en&ref=120045-32**](http://www.iblj.com/abstract.htm?lg=en&ref=120045-32)

Abstract:

The contract for the construction of industrial facilities is a complex long-term contract featuring diverse obligations and raising significant risk management issues. Unlike more traditional contracts, this contract does not benefit from any tailor-made provisions found in the German Civil Code. As a result, legal scholars have had to define it and analyze its particularities. While German case law and most scholars classify the industrial facility construction contract as a contract for works, the provisions of the German Civil Code dealing with contracts for works are either absent or not well-suited to address efficiently the real issues in large infrastructure projects. This situation has necessitated the development of solutions to fill the legislative gap in practice. Associations of builders or developers have played an important role in this regard by promulgating guides and model contracts.  More importantly, a specific set of terms and conditions specially adapted to construction projects and known as “VOB” conditions have been initiated by public authorities and enjoy a widespread recognition in the industry.  Finally, the lack of suitability of the German Civil Code has encouraged project participants to negotiate detailed contracts with the hope of avoiding the applicability of statutory provisions. This trend indicates the emergence of a form of customary law, which, by reference to a similar phenomenon in the international contract practice, could be called “lex mercatoria germanica”.

Extract:

Conditions relating to the award and the completion of construction works: Conditions VOB

Legal status of the VOB conditions:

* Recourse to the VOB conditions is compulsory for state utilities awarding public works construction contract, their use for private construction projects is optional
* Jouent un rôle considérable sur le marché allemand de la construction et en particulier pour les contrats de réalisation d’ensembles industriels
  + Pour certains fondamentales dans le droit de la construction allemand

Contents of the VOB Conditions:

Divided into 3 sections:

* VOB/A section includes the rules governing the award of public works,
* VOB/B section is a list of contract clauses: constitutes a model of general conditions similar to the FIDIC Contract conditions at the international level
  + In 18 articles, these conditions attempt to cover exhaustively the main contractual and legal issues recurrently arising in the context of large construction projects
    - Remuneration of the contractor, conditions applicable to the completion of the works on the site and delays in the project schedule, termination of the contract, transfer of risks, indemnifications and liabilities, liquidated damages, take-over of the works, warranty ans settlement of disputes
* VOB/C section contains technical norms applicable to construction projects

VOB conditions: useful instrument to fill the German legislative gaps

* The need for cooperation and communication between the parties involved
  + Art 3 and 4.1 and 4.4
* Address also the circumstances giving rise to time extension and additional cost compensation in several provisions
  + Art 2.5 and 4.9 and 6
* Risk of destruction of the works by unexpected events
  + Art 7
* Finally, the VOB conditions set aside the BGB rules on cancellation of contracts and authorize only contract termination which is a much more realistic approach in view of the size and nature of large construction projects
  + Art 9

The trend towards “contract without a Governing law”

* Participants’ desire to achieve a certain independence from the legal system in which they evolve in doing so they prompt the rise of a form of autonomous law designed for large construction projects

1. The urge for independence vis à vis statutory norms

* through very detailed contracts, the parties attempt not only to cover all possible difficulties likely to arise during the project execution but also to escape simultaneously any law that would otherwise be applicable to such a contract
  + leads to contract “without a governing law” in practice: contracts are supposed to be self sufficient fully freed from any legal system governing the contractual situation
    - ex: penalty clauses: BGB pples: only a min assessment of the expected damage that would result from a breach of contract
    - but permissible to derogate contractually from this statutory pple and many contracts prevent the owner from claiming further damages beyond the caps agreed for the penalty clause
* There is a clear intent by participant in German construction projects to avoid legislatives rules, subject of course to the applicability of mandatory statutory provisions
  + But German law attempts whenever appropriate to limit the applicability of mandatory rules when the contract is between professionals

The consequences of the trend towards “contracts without a governing law”: development of a set of customary rules specially adapted for large construction projects

2. The development of a customary law for large construction projects

* When elaborating sophisticated cntracts, the parties involved in large construction projects take part (consciously or unconsciously) in the debelopment of a legal phenomenon regered to as “a certain form of autonomous law” (W. Kirchgasser)
* Other scholars: “a modern type of contract”
* Comparison of these statements with the idea of the Emergence of a Lex Mercatoria adapted for the needs of international business
  + Lex mercatoria assembles a certain number of fundamental principles that arise from the international contract practice
  + Berger: recent efforts of international practice (such as the publication of the UNIDROIT principles) for international commercial contracts could serve as a reference to define the content of the lex mercatoria
  + Would it be possible to consider that the VOB conditions because they were drafted especially for the construction market by representatives of the various professional groups involved in such market, constitute a form of codification of fundamental principles for large construction projects ?

**2° LE GOFF, Pierrick : A new standard for international turnkey construction contracts: The FIDIC Silver Book, RDAI 2000, p. 151.,** [**http://www.iblj.com/abstract.htm?ref=22000151-158**](http://www.iblj.com/abstract.htm?ref=22000151-158)

The Need for a New Standard for International Turnkey Contracts / The Silver Book in a Nutshell / What is the Future of the Silver Book?

* 1998 : Silver Book

1. The need for a new standard for international turnkey contracts

EPC contracts are the result of a wave of liberalization of certain economies mainly in Asia and Latin America

* especially true of the electricity sector where deregulation and privatization have enabled independent power producers to enter the marker, thereby creating a significant number of privately financed power plants construction projects in developing countries
  + countries have enabled the investment of private funds in the development of local economies
* An interesting feature: the purchaser (owner) is almost invariably a company created specifically for the particular project
* Another major feature of EPC projects: the strong involvement of the financing institutions in the contractual relations between the contractor and the owner
  + Lenders/banks are entitled to specified rights of supervision during the performance of the contract (visit/witness of test)
  + Need for specific contract terms which are not needed for contracts involving publicly financed turnkey infrastructures

2. The silver book in a nutshell

* Employer/purchaser: giving the contractor access to the site, assisting the contractor with obtaining licenses and permits, and paying the contract price
  + an interesting feature of the SB is the requirement that the Employer provide the Contractor with reasonable evidence that financial arrangements have been made to enable the Employer to pay the Contract Price
    - in absence of which the Contractor may terminate the contract
      * often because the Employer is a typical EPC turnkey project : Special Purpose Company with minimal assets
* Contractor: obtain the necessary permits and licenses, carry out the design of the works, provide the Employer with the required operation and maintenance manuals, put in place the agreed performance bonds as security for the due performance of the contract and more generally to provide the works on a turnkey basis and remedy defects in accordance with the contract
  + Particularity of the SB: place on the contractor the risk of unforeseen ground conditions
    - General pple according to which the Contractor is to accept “total responsibility for having foreseen all difficulties and cost of successfully completing he Works”
      * Lenders rely heavily on the certainty of the project costs and schedule: so insist on limiting the number of possibilities for the Contractor to clim extra costs or extra time to perform the works
  + Also the SB contains a full array of standard clauses for major turnkey contracts
* Finally the SB contains a detailed clause regarding the settlement of disputes which, absent of an agreement to the contrary, are to be settled under the arbitration rules of the ICC Article 20
  + Notable characteristic of the settlement of disputes clause is the provision of a fast track pre-arbitration procedure through the constitution of a Dispute Adjudication Board
    - 84 days: decision
    - if parties unsatisfied: full-fledged arbitration

3. What is the future of the SB?

* First it is likely that potential Employers and Contractors will be dissatisfied by the position taken by the SB on certain crucial issues
  + The need to amend the SB to suit a particular project or the general corporate policy of the participants should not be viewed as a significant impairment to its possible use
* Second: although the Sb is primarly intended for EPC turnkey projects involving private finance, it appears that several features typically involve in such projects are missing
  + SB generally silent on the Lenders’ involvement on the project
  + But it recognizes that there may be a need for additional clauses to satisfy the requirements of financing institutions
    - Responsibility of the potential users to tailor the silver book via special conditions to respond to the particular desiderata of the lenders
* Finally, the SB arrives on the market at a time when EPC projects developed with recourse to private project finance have been in existence for several years
  + American and UK law firms: already developed their own standards for EPC contract
    - But reduction of the costs and speed up the process
* Several years needed to fully appreciate how the SB is being received by the international construction industry

**3° The many lives –and faces- of Lex Mercatoria: History as Genealogy in International Business Law, Nikitas E. Hatzimail,** [**http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=1484&context=lcp**](http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=1484&context=lcp)

For over a half century, it has been claimed that cross-border business transactions are governed by a transnational body of norms specific to international trade: generally known as lex mercatoria, the “law merchant.” This legal phenomenon is in fact often described as the “new” lex mercatoria, as distinguished from the “ancient” law merchant, which purportedly flourished in medieval and early modern Europe.

Reading about lex mercatoria is reminiscent of the proverbial Arlésienne: we never get to see her but every one talks about her :

* many have denied its existence
* debate : more and more theorists
* **What is lex mercatoria ?**

Lex mercatoria has been variously described by its advocates as:

* “**a set of general principles and customary rules spontaneously referred to or elaborated in the framework of international trade, without reference to a particular national system of law,”**
* a “regime for international trade, spontaneously and progressively produced by the societas mercatorum,”
* “a single autonomous body of law created by the international business community,”
* “a hybrid legal system finding its sources both in national or international law and in the vaguely defined region of general principles . . . called ‘Transnational law’”
* “[the] phenomenon of uniform rules serving uniform needs of international business and economic co-operation,”

In the end, regardless of whether an autonomous legal system of transnational commercial law exists now or shall exist in the near future, today lex mercatoria exists as a concept, with strong resonance and powerful symbolic capital.

The divergence of opinion is noticeable even at the level of definition.

There is disagreement as to:

* the legal nature of lex mercatoria (is it a “legal system” complete with its metanorms, a “body of law” less systematic but rather coherent, or a “phenomenon”?),
* as to the process of its creation (spontaneous or evolutionary),
* and as to the lawmaking role of business actors themselves.
* The main dividing line concerns the relationship of lex mercatoria with state law and more generally the states system.
  + There are two main camps:
    - the former—call them “purists” or “autonomists”—insist on the “a-national” or “stateless” character of lex mercatoria.
    - The latter—call them “integrationists”— insist on the ability to “freely combine elements from national and non-national law.”

Article examines in detail two paradigmatic narratives of *lex mercatoria* historiography: the principal historical accounts provided by the two founding fathers of the modern *lex mercatoria*, Clive Schmitthoff and Berthold Goldman

These two historical accounts come from two classic essays providing a comprehensive outlook of the authors’ respective worldviews and normative projects: genealogical narratives form a vital part of the argument in both essays

Schmitthoff and Goldman were instrumental in the formation and shaping of the *lex mercatoria* discourse from its beginnings in the early 1960s until the late 1980s.

More generally, they played important roles in the academic elaboration of international commercial law and international commercial arbitration.

They are also regarded as emblematic of the two basic approaches to *lex mercatoria*:

* **with Schmitthoff emphasizing the use of state and nonstate sources,**
* **and Goldman insisting on the stateless (a-national) character of *lex mercatoria*.**
* **Conclusion**

Article studied the accounts of the two founding fathers of lex mercatoria, who are also identified with the two principal approaches within the mercatorist coalition.

* **Schmitthoff** sought to construct a uniform law of international trade with merchant customs and trade practices alongside international instruments, and possibly national legislation.
  + He even suggested that such coexistence might allow for better growth and adaptability of international business law in the long run.
* **Goldman** was, on the contrary, preoccupied with providing a theory of an autonomous legal system independent from (while respected by) state legal systems (including intergovernmental institutions).

Both are in effect seeking to provide theoretical foundations for something:

* Schmittthoff seeks a foundation for international legislative initiatives and for “vertical” academic treatment of international business law.
* Goldman seeks a legal justification for arbitrators using their good judgment, their knowledge of, and “feel” for the law.

Competing as they may appear, the two narratives do share a lot. They do not differ in their basic facts (medieval customary law, early modern incorporation by state law, low-key persistence of innovative mercantile practice, postwar resurgence of transnational commercial law). They share this normative commitment to the autonomous regulation of transnational business, which is characteristic of all mercatorists. They also share, along with most mercatorist literature, their basic sentiment—what another author calls “the romance of the law merchant.”

**4° Additional document for reference: UNCITRAL Legal Guide on Drawing Up International Contracts for the Construction of Industrial Works** [**http://www.uncitral.org/pdf/english/texts/procurem/construction/Legal\_Guide\_e.pdf**](http://www.uncitral.org/pdf/english/texts/procurem/construction/Legal_Guide_e.pdf)

Cours 4 - Préparation

**Global Law: A legal Phenomenon emerging from the process of Globalization, P. Le Goff**

* In connection with the process of globalization and its impact on international trade, the question has arisen as to whether a notion of global law, converging around common international practices and values, is emerging for the benefit of multinational economic players and the international community at large
* Ole Lando : "[t)he growing globalisation requires a harmonisation and unification of the rules of law governing world trade."
* Diverging national laws create significant obstacles to cross-border transactions, such that efforts toward the harmonization of national legal principles through the production of a "set of global substantive rules" are more than welcome.
* As Professor Ribstein understandably pointed out during the Indiana University School of Law symposium, *Globalization of the Legal Profession,* it appears that the concept of global law is rather lacking the precision and formality one would normally expect from a classical legal system.

**I. THE NOTION OF GLOBAL LAW**

***A. Global Law and Related Legal Notions***

*1. Global Law and International Public Law*

* International public law is traditionally defined as the set of norms and rules governing the relations between governments or state entities.

*2. Global Law and International Private Law*

* it can generally be said that this field of law serves the purpose of establishing i) rules for the selection of the law applicable to an inter- national situation or contract and ii) rules for the selection of the court competent to rule over an international dispute.
* In a nutshell, international private law covers both the areas of conflict of laws and conflict of jurisdictions.
* in the end, international private law leads to national law and national courts; once a governing law is designated by applying the relevant choice of law rule, such governing law is the national law of a specific country.
* International private law is actually not a very international legal field.
* Since global law is supposed to find its roots in the emergence of internationally recognized legal rules and principles of interest for the world economy at large, its basis is very international compared to international private law and its ambition is to cover much more ground than just choice of law or competent court selection.

*3. Global Law and Comparative Law*

* Comparative law is about comparing, and the comparison is generally between i) national laws of different countries (e.g., comparing German law and English law) or ii) groups of legal systems (e.g., comparing common law and civil law systems)
* Comparative law is also fundamental to the process of international harmonization, since it enables the identification of diverging views between national laws and the submission of proposals to make such laws converge toward a unified solution.
* The essence of comparative law is to compare national laws

*4. Global Law and International Economic Law*

* The broad field of international economic law certainly covers many areas that global law is meant to cover
* The rules governing the World Trade Organization constitute the backbone of international trade law, which is one of the components of inter- national economic law.
* the multidisciplinary nature of the notion of global law requires extending the frontier of global law beyond mere trade relations.
* cross-border pollution
* This leads us to conclude that global law is broader than international economic law

*5. Global Law and the Lex Mercatoria*

* The *lex mercatoria* can be defined as a collection of transnational legal principles, which derive from international contract practice and are especially suited to meet the needs of international commercial transactions.
* U. Stein: "There are doubts about the nature and scope of the *lex mercatoria,* about its legal basis, its field of application, its sources, its state of development and its relation to national and international law."
* Professor Berger at the Center for Transnational Law of the University of Cologne in Germany, clearly ac- knowledge the existence of the *lex mercatoria* as the expression of global economic reality.
* the *lex mercatoria*
* rely expressly on the *lex mercatoria* as a body of governing legal principles applicable to the contract.
* We believe, however, that the notion and scope of global law is much wider than the *lex mercatoria,* since global law is not meant to be restricted to the development of legal principles exclusively applicable to international commercial contracts. Obviously, the *lex mercatoria* plays an important role as a body of norms evolving in a globalizing economy. The *lex mercatoria* should not be treated, though, as being similar to the notion of global law, but as constituting one of its key elements.

***B. Global Law: Attemptat a Definition***

This leads us to make a proposal presenting global law primarily as a multicultural, multinational, and multidisciplinary legal phenomenon, which has not yet reached the maturity and formality of a structured legal system

***1.*** *Global Law Is a Multicultural, Multinational and Multidisciplinary Legal Phenomenon.*

* The foregoing developments on global law and related legal notions teach us that global law is broader than legal fields such as comparative law, international private law, or international public law. **All** these legal fields are relevant to the process of globalization of the world economy, but are too narrow to reflect its overall dimension. Thus, they can only be viewed as forming part of the contents of the notion of global law. The fact that all these fields, without exception, are included in the course offerings of major law schools or institutes focusing on global law confirms this analysis.
* A large variety of international and multidisciplinary legal fields. On this particular point, we fully share the views expressed by Professor Weiler, Faculty Director of the Hauser Global Law School Program, who explains that "Global Law School is not only, or even mostly, about 'International' or 'Globalization' with a capital I or 'G' but is a reflection of the internationalization and globalization *of all dimensions of law,* be they corporate or environmental.",
* we would tend to define global law as a multi- cultural, multinational, and multidisciplinary legal phenomenon finding its roots in international and comparative law and emerging through the international legal practice that was prompted by the globalization ofthe world economy. What conclusions can be drawn from this definition? This is precisely what we need to address next

*2. Global Law Does Not Yet Constitute a Formal and Structured Legal System*

* Professor Ribstein during the Indiana University School of Law symposium, *Globalization of the Legal Profession:* It is indeed correct that there is currently no "Global Law Code" or other formal legal instrument or database to access precise information on the rules and regulations forming global law. It is equally correct that there is no "Global Law Court of Justice" sanctioning violations of the global law and setting forth global law judicial precedent.
* A decent indication that global law is moving in this direction is seen in the developments in the field of international criminal law, which is an area of law falling within the notion of global law according to our definition. The summary of the core achievements of the International Criminal Tribunal for the former Yugoslavia, emphasized that the Tribunal
* [H]as expanded the boundaries of international humanitarian and international criminal law.... It was the first international criminal court to enforce the existing body of international humanitarian law, and in particular judicially determine its *customary law aspects....* It has created an *independent system of law,* comprising elements from adversarial and inquisitory criminal procedure traditions.... The Tribunal has created a *Judicial Database* of all its jurisprudence
* In another area, namely international trade law, H. van Houtte and P. Waute- let remind us that various websites are dedicated to the collection of decisions applying the 1980 United Nations Convention on Contracts for the International Sale of Goods, and that arbitral awards applying the Principles of International Commercial Contracts conceived by UNIDROIT are now published on the website of this organization.
* Against these developments, the authors conclude: "Globalization, the very phenomenon that called for the creation of uniform rules, lends a helping hand in securing an international reading of uniform rules."
* As we can see, there is hope for more formalism and more precision in the development of global law and in the definition of its parameters.
* By comparison, when referring to the notion of global law, Professor Paliwala distinguishes between the "regional global" and the "universal global" approach. This is an indication that global law will not emerge simultaneously on a worldwide basis.
* Once the efforts toward shaping these sub-categories reach a more advanced stage, an overarching vision of the concept and con- tents of global law will emerge more clearly.

**II. THE CREATION OF GLOBAL LAW**

*It would be too burdensome to review in an exhaustive manner all institutions and groups of legal professions influencing or taking a leading role in shaping the contents of global law. We will therefore focus on a few selected examples enabling us to outline in a clear manner the process of developing norms, principles, and regulations specifically adapted to the needs of a global economy.*

***A. The Role ofInternationalOrganizations***

*1. The United Nations*

* The impact of the United Nations is tremendous.
  + Institutions such as the World Bank, the International Monetary Fund, the World Intellectual Property Organization, the World Health Organization, or the United Nations Industrial Development Organization contribute to the emer- gence of norms, rules, or practices of direct relevance to the development of global law
* Slowly but surely creates a set of global references, even for private projects not funded by the World Bank.
  + If we take the field of international construction projects, UNCITRAL has developed very useful tools for international practitioners, such as the UNCITRAL legal guide on drawing up international contracts for the construction of industrial works or the more recent model legislative provisions on privately financed infra structure projects.
* Professor Gross and Dean Cachard emphasize that they constitute some form of "soft law" developed by UNCITRAL after a thorough analysis of the contractual practice in relation to BOO (Build-Own-Operate) projects.

*2. The European Union*

* Live example of a regional effort toward harmonizing legal systems.
* Major advantage of the European Union is the existence of the European Court of Justice, which enables judicial precedents to be consistent throughout the Member States.
* In addition, the European Union has embarked more recently on wider legislative efforts with a view to accelerate the process of harmonization.
* The best example is probably the initiative of the European Commission to solve the divergence of national contract law by searching for more aggressive and broader unification in this field.
* All of this goes in the direction of establishing a "hub” of global contract law within the wider notion of global law.

*3. The International Chamber of Commerce*

* The International Chamber of Commerce (ICC) presents itself as the "world business organization.
* Among the highlights, the Incoterms (e.g., Ex Works, Free on Board, Cost Insurance & Freight, Delivered Duty Paid) certainly join the top ten of the best achievements of the ICC
* By compiling standard trade definitions most commonly used in international sales contracts, the Incoterms "are at the heart of the world trade," as the ICC proudly publicizes.

The ICC Model Contracts are another major contribution of the ICC worth mentioning.

*4. InternationalArbitrationCenters*

* International arbitration is a preferred way to settle international disputes
* For international construction projects, for instance, the normal approach is to exclude the competency of national courts in favor of an arbitration panel.
* As a result, international arbitration centers are necessarily at the heart of the development of practices shared by international lawyers and, consequently, contribute to the forming of this important area of global law.
* International arbitration centers facilitate the definition of and access to the source of law in the field of international commercial arbitration and, by the same token, are part of the global law experience.

*5. InternationalTradeAssociations*

* International trade associations regroup individuals or companies that belong to the same economic branch and are involved in international matters. Through- out the world, the number of these associations is difficult to estimate, but there are certainly thousands of them in all types of markets
* The most well known at the international level is the International Federation of Consulting Engineers (FIDIC) seated in Geneva, Switzerland
* For the benefit of their members and of international lawyers advising clients in the relevant industries, these trade associations produce very useful guidelines and model contracts that are quite widely used by practitioners.
* Of very global application are the various FIDIC conditions of contract, which are regularly encountered on numerous construction projects worldwide.
  + Worth mentioning among the FIDIC collection is the "FIDIC Silver Book-Conditions of Contract for EPC Turnkey Projects," which constitutes one of the most recent inter- national model contracts for privately financed infrastructure projects.

***B. The Role of International Law Practitioners***

* It will certainly not come as a full surprise that international lawyers strongly contribute to the development of global law. To a large extent, they stand to benefit the most from it.
  + As H. van Houtte and P. Wautelet put it, "[b]y far the greatest obstacle the international lawyer faces... is the existence of widely diverging national laws.... It is no wonder, therefore, that lawyers have welcomed the at- tempts of states and various organizations to unify and/or harmonize national legal rules."

*1. Global Law Firms*

* With such global infrastructures, international law firms clearly have the potential to contribute to the emergence of global law, and do so effectively. These firms traditionally work on major cross-border transactions.
* The role of global law firms in the process of legal harmonization transpires through their endeavors to ensure consistency in quality and to offer seamless legal service throughout their multi-office base.

*2. Global In-house Legal Departments*

* Multinational corporations are equipped with global in-house legal departments. Similar to global law firms with their multi-office base, global legal departments are made of in-house lawyers based at the main geographical sites where the corporation has a foreign industrial or commercial presence. Global legal departments are more discreet than global law firms, since their services are for the exclusive use of their employer.
* An interesting feature of global legal departments is that they need to integrate and spread identical corporate and business values over groups of lawyers with very diversified cultural, ethnic, and professional backgrounds. It is not unusual for legal departments of major international corporations to exceed the symbolic threshold of more than 100 members coming from a multitude of foreign jurisdictions and having different legal education or professional qualifications.

*3. InternationalJudgesandArbitrators*

* The contribution of judges and arbitrators involved in international cases to the development of global law is so obvious that only a few lines are needed to explain it. Actually, we have already touched upon this aspect when explaining the input of the International Criminal Tribunal for the former Yugoslavia in the formation of international criminal law.
* Burke-White refers with pertinence to the notion of "Judicial Globalization" when discussing the legal significance ofthis practice.
* As to international arbitrators, we have already mentioned their leading contribution in establishing and enforcing legal principles specifically suited for international commercial relations.

*4. International Lawyers' Associations*

* the International Bar Association (IBA), which presents itself as "the global voice of the legal profession."
* Another classic example is the Swiss Arbitration Association (ASA), which gathers Swiss and foreign lawyers specialized in, or having a strong interest in, the field of inter- national arbitration."

*5. International Alumni Associations*

* Similar to international lawyers' associations, international alumni associa- tions enable a multilateral flow of information and sharing of expertise among legal experts, especially if they are active in organizing alumni reunions

***C. The Role of Universities***

This article would be severely incomplete without mentioning the crucial role played by universities in the process of global law creation. Addressing the services rendered by universities toward the shaping of this international regime is all the more appropriate for a publication in a law review dedicated to global legal studies.

*1. International and Comparative Law Curriculum*

*2. International and Comparative Law Reviews*

*3. International Exchange Programs*

*4. International or Comparative Law Institutes*

**CONCLUSION**

Without the tremendous efforts deployed by international organizations, international practitioners, universities and other academic institutions such as international and comparative law institutes, the status of development of global law would probably be too negligible to dare to write about it. Even so, this does not imply that the status is very advanced. Much more needs to be done before all sub-categories of global law evoked in this article converge through a pyramidal effect toward a fully recognized and stand-alone global law system, with its own Global Law Code and its own Global Court of Justice applying it. Nevertheless, the current situation tells us that global law is in motion. It is a fact, not just a theory, and we can all contribute to it.

**The Lex Mercatoria and International Contracts: A challenge for International Commercial Arbitration?; A.F.M. Maniruzzaman, American University International Law Review, 1999**

1. The theory of the Lex Mercatoria
2. Different aspects concerning the Lex Mercatoria:

70. *See* Mustill, *supra* note 4, at 174-77. For an understanding of those rules it seems reasonable to reproduce them in the following manner:

1. A general principle that contracts should prima facie be enforced according to their terms: *pacta sunt serranda.* The emphasis given to this maxim in the literature suggests that it is regarded, not so much as one of the rules of the *Iex mercatoria* but as the fundamental principle of the entire system.

2. The first general principle is qualified at least in respect of certain longterm contracts, by an exception akin to *"rebussic stantibus'.* The interaction of the principle and the exception has yet to be fully worked out.

3. The first general principle may also be subject to the concept of *abus de droit.* and to a rule that unfair and unconscionable contracts and clauses should not be en- forced.

4. There may be a doctrine of *culpa in contrahendo.*

5.A contract should be performed in good faith.

6. A contract obtained by bribes or other dishonest means is void, or at least unenforceable. So too if the contract creates a fictitious transactions designed to achieve an illegal object.

7. A State entity cannot be permitted to evade the enforcement of its obligations by denying its own capacity to make a binding agreement to arbitrate, or by asserting that the agreement is unenforceable for want of procedural formalities to which the entity is subject.

8. The controlling interest of a group of companies is regarded as contracting on behalf of all members of the group, at least so far as concerns an agreement to arbitrate.

9. If unforeseen difficulties intervene in the performance of a contract, the parties should negotiate in good faith to overcome them, even if the contract contains no revision clause.

10. 'Gold clause' agreements are valid and enforceable. Perhaps in some cases either as gold clause or a 'hardship' revision clause may be implied.

11. One party is entitled to treat itself as discharged from its obligations if the other has committed a breach, but only if the breach is substantial.

12. No party can be allowed by its own act to bring about a non-performance of a condition precedent to its own obligation.

13. A tribunal is not bound by the characterization of the contract ascribed to it by the parties.

14. Damages for breach of contract are limited to the foreseeable consequences of the breach.

15*.* A party which has suffered a breach of contract must take reasonable steps to mitigate its loss.

16. Damages for non-delivery are calculated by reference to the market price of the goods and the price at which the buyer has purchased equivalent goods in replacement.

17. A party must act promptly to enforce its rights, on pain of losing them by waiver. This may be an instance of a more general rule, that each party must act in a diligent and practical manner to safeguard its own interests.

18. A debtor may in certain circumstances set off his own cross-claims to extinguish or diminish his liability to the creditor.

19. Contracts should be construed according to the principle *ut res magis valeat quampereat.*

20. Failure by one party to respond to a letter written to it by the other is regarded as evidence of assent to its terms.

1. The role of Arbitrator in the development of the Lex Mercatoria
2. Application of the Lex Mercatoria by tribunals: the present state
3. The Lex Mercatoria as a Legal Order
4. Applying “Rules of Law” instead of a Legal System to settle international Contract disputes
5. The Lex Mercatoria as a Legal Process: the conceptual framework and caveat
6. Impediments towards the growth and development of the Lex Mercatoria

**CONCLUSION**

Having thus made observations and cautionary remarks on the various important aspects of the lex mercatoria, a few conclusions may be drawn. Although, from the positivists' point of view, the lex mercatoriais not a legal system per se and hence cannot be itself the proper law of an international commercial contract, there seems to be a recent trend to endorse the view, in both national and international arbitration practice, that "rules of law," which could include the lex mercatoria, may be applied in certain circumstances as well as on their own. The philosophy seems to be that if "rules of law" pro- vide suitable resolutions to a dispute, it is not necessary to consider whether they constitute a legal system.

Since there still remains serious disagreement among jurists as to the sources, methodology, and contents of the lex mercatoria, some are content to hold the view that the lex mercatoria may serve the purpose, at best, of subsidiary rules for the settlement of a dispute in hand. Professor Lowenfeld has considered that the status of the lex mercatoria is not, in other words, supposed to be revolutionary. What it does do, if properly used, is to clarify, to fill gaps, and to reduce the impact of peculiarities of individual countries' laws, often not designed for international transactions at all."

Even in the corpus of the lex mercatoria, some may claim that certain rules belong to it, while others are doubtful that those rules apply. Thus, the differences in formulation may lead to an incoherent body of rules to be claimed as the lex mercatoria, which, in turn, may cause the unpredictability of the outcome of any dispute.

It should be noted that the application of the lex mercatoria, or the third legal order, has been found to be acceptable either as an express choice-of-law provision or directly as applicable substantive law, in the absence of any choice of law, without reference to any conflict rules. In the present state of development of law, the application of the lex mercatoria to an international contract contrary to an express choice of a different law is not tolerated.

Sometimes arbitrators seem to be overtaken by their preconceived views and legal dogma, even in disregard of the actual context of the case. In many arbitral awards, arbitrators fail to provide sufficient reasons for their decisions on substantive matters, which may lead to ambiguous interpretations among jurists. This state of affairs in the context of international commercial arbitration is not favorable for the sound growth and development of the lex mercatoria. A global institutional control mechanism should be established to standardize international arbitral practice and jurisprudence and to help develop a consistent body of arbitral lex mercatoria. On the threshold of the twenty-first century, international commercial arbitration as an institution, with its growing popularity amongst the international business community, faces a tremendous challenge to develop a consistent body of international jurisprudence on the lex mercatoria that may be universally acceptable.

Cours 5 - Préparation

**Notion of “best efforts”:** [**http://www.callawyer.com/Clstory.cfm?eid=890865**](http://www.callawyer.com/Clstory.cfm?eid=890865)

 A "best efforts" clause must be one of the **most misunderstood provisions** to consistently worm its way into an agreement. To put such a claim to the empirical test, take a moment to define for yourself what is required by a party who promises to use best efforts to fulfill a contract obligation.

OK, have you given it your best effort?

A common assumption is that "best efforts" means exercising the highest level of duty required. In some cases, this isn't far off.

Contractual language: The next lawyerly instinct you might have is to look at the letter of the agreement to discern exactly what you are required to do under the best efforts clause. Unfortunately for you, all it says is that you are required to use your best efforts to market and promote what is now an outdated product. It gives no indication about how those efforts will be measured.

Case law: Some courts have defined best efforts by comparing it to other recognized diligence standards. For example, in National Data Payment Systems, Inc. v. Meridian Bank, the court held: "The duty of best efforts 'has diligence as its essence' and is 'more exacting' than the usual contractual duty of good faith." (212 F.3d 849 at 854 (2000).)

      And United Telecommunications, Inc. v. American Television & Communications Corp. (536 F.2d 1310 (1976)) held that, as between commercial parties, a best efforts clause is intended to impose a duty beyond a good faith, duly diligent performance of the contract. Hardly the clear-cut rule of law that tells you whether you are in breach of your agreement. (It would be a lot easier to become a celebrity and read about yourself in People.)

      Nearing desperation in your research efforts, you reach out to find the unpublished decision of Krinsky v. Long Beach Wings (2002 Cal. App. Unpub. LEXIS 9026) and digest its ruling. In construing best efforts, the court in that case observed that "the plain meaning of the term denotes efforts more than usual or even merely reasonable."

Code provisions: Uniform commercial code

The "standard industry practice" has served as a gauge for determining whether efforts are sufficiently "best" to defeat a claim for breach. (See Zilg v. Prentice-Hall, 717 F.2d 671, 681 (1983), cert denied, 466 U.S. 938 (1983), finding that the defendant's efforts were "perfectly adequate," although the defendant did not follow through as well as he might have.) But this assumes that industry standards can be identified.

* Here's the point: **Because of the uncertainty surrounding the legal effect of a best efforts promise, the best approach appears to be treating these clauses as unenforceable if they lack any objectively measurable standards.** (See Pinnacle Books, Inc. v. Harlequin Enter. Ltd., 519 F. Supp. 118, 12122 (1981): absent an objective criteria by which to measure performance, "best efforts" clauses are so vague as to be unenforceable; Jillcy Film Enter., Inc. v. Home Box Office, Inc., 593 F. Supp. 515, 520–21 (1984) (accord).)

In Pinnacle Books, an author granted his publisher an option to renew the parties' contract for a series of books. The agreement provided, however, that if after extending their best efforts, the parties were unable to reach an agreement, the author would be free to offer his rights in these books to any other publisher. The court held that this best efforts clause was unenforceable because its terms were too vague.

      Specifically, it held: " 'Best efforts' or similar clauses, like any other contractual agreement, must set forth in definite and certain terms every material element of the contemplated bargain." **And also: "Essential to the enforcement of a 'best efforts' clause is a clear set of guidelines against which the parties' 'best efforts' may be measured."** (519 F. Supp. at 121.)

      Furthering this end, the court noted: "Unless the parties delineate in the contract objective standards by which their efforts are to be measured, the very nature of contract negotiations renders it impossible to determine whether the parties have used their 'best' efforts. ... Thus, absent express standards, a court cannot decide that one party's offer does not constitute its best efforts; nor can it say that the other party's refusal to accept certain terms does not constitute its best efforts." (519 F. Supp. at 122.)

**This isn't hard: All it means is that if the parties are intent on including a best efforts clause, they must clearly define for themselves within the body of the agreement precisely what this means and how it will be measured**. They need to set guidelines a court can use to determine what was required by the promisor and whether those requirements were met.

      In the case of your agreement to sell software, for example, the contract might have included a requirement that you offer those products, explain their features, and wait for the customer to expressly ask for another product before you offer one. It might require that you offer the manufacturer's product to 100 prospective customers per month, or at least to as many as you offer any competitive product. As long as the agreement contains some objective standards, it would allow for a clear determination of breach.

      But without any measurable standards, the parties and the trier of fact are left to wonder what was meant by the term best efforts. Standing alone, its meaning is nebulous and its enforceability tenuous. This is risky business: It subjects one party to a claim for breach for having failed to perform to a level it never intended—and would never have agreed to—and subjects the other party to losing the benefit of a promise for which it thought it had bargained.

      When it comes to contractual provisions, no one benefits by being left to guess at what was meant by the words on the page. A best efforts clause must

**Kenneth A. Adams** [**http://www.adamsdrafting.com/downloads/Best-Efforts-Practical-Lawyer.pdf**](http://www.adamsdrafting.com/downloads/Best-Efforts-Practical-Lawyer.pdf)

 Contract provision using the phrase best efforts or one of its variants are often a source of contention and confusion when a contract is being negotiated. They can also be a source of dispute after the contract has been signed. This article analyzes how lawyers use best efforts and its variants; what best efforts and its variants mean when not defined by contract; and how courts go about determining whether a party has made the required efforts. **This article recommends that if you provide in a contract that a party is subject to an efforts standard, generally you should specify by means of a defined term what sort of actions would satisfy that requirement**. This article discusses which defined term to use and how to define it, and also ad- dresses issues relating to the wording of efforts provisions.

Contracts impose an efforts standard in connection with many different obligations, such as an obligation to cause a registration statement to become effective by a certain time, an obligation to obtain consents required for closing, or an obligation to promote sales of a product.

Some courts have held that the appropriate standard is one of good faith.

As an alternative to a good faith standard, some recent cases have used a reasonableness standard.

The case law on the meaning of best efforts suggests that instead of representing different standards, other efforts standards mean the same thing as best efforts, unless a contract definition provides otherwise.

Determining whether a party has complied with an efforts provision is facilitated if the efforts that were actually made can be compared against some benchmark

* promises made during the negotiations
* industry practice
* efforts used by the promisor in connection with other contracts imposing an efforts standard
* how the promisor would have acted if the promisor and promisee had been united in the same entity

Although the term best efforts and its variants are a standard feature of contracts, there is much confusion surrounding what those terms mean. Furthermore, a court could hold that a party subject to an efforts provision was obligated to make efforts out of proportion to the benefits to it under the contract in question. When in drafting a contract you wish to require that a party act diligently to further a contract goal, you could avoid these problems by using the defined term reasonable efforts and using the definition recommended in this article, while counsel to a party on whom such a requirement is imposed should consider the possible carve-outs listed in this article.

**Be Clear When Using Best Efforts, By Christopher W. Hamlin**

It is not uncommon for parties en- tering into an agreement to include a provision requiring one or both to use their *best efforts* in performing certain duties or obligations. The underly- ing reasons for this vary but typically involve some degree of uncertainty that the parties are attempting to ad- dress or mitigate.

If not careful in crafting *best efforts* language, though, parties may create uncertainty in their agreement and, in some cases, make it unenforceable. The risk to each side, both promisor and promisee, is that neither may be certain what actions will be neces- sary to satisfy an obligation to use *best efforts* or whether the provision will be enforceable at all.

Although the term *best efforts* is commonly used, if it is not clearly defined, the potential exists for dif- ferent understandings by parties and varying standards applied by courts, leading to unanticipated results.

This article explores the treatment of *best efforts* clauses in Missouri, Illinois, New York and Delaware, and provides general guidance on drafting such provisions in a manner that is more likely to add clarity and predictability to an agreement and increase the likelihood of fulfilling a client’s expectations.

* Missouri

In Missouri, early decisions indi- cated that courts viewed *best efforts* clauses as too indefinite and uncer- tain to be enforceable, similar to illu- sory promises to use one’s influence or recommend a certain course of ac- tion.7 Later cases, however, indicate that Missouri courts will enforce *best efforts* provisions, especially where specific objectives are enumerated in the agreement.8 The case law in this area, however, is sparse and does not provide the practitioner much guid- ance, let alone a tangible rule.

The *Waterway* and *Brady* holdings suggest that Missouri courts gener- ally acknowledge the validity of *best efforts* clauses and will enforce them when there is evidence that a party has performed in accordance with the applicable agreement. Because, however, Missouri courts have not articulated a specific standard for enforcing *best efforts* clauses, it is difficult to predict under Missouri law when a party has fulfilled such an obligation unless the criteria for doing so are clearly set forth in the agreement.

* Illinois

Unlike Missouri, Illinois has an abundance of case law regarding *best efforts* provisions. Although some holdings in Illinois appear to be inconsistent on their face, the law may be better described as *developing* and highly dependant on the facts of each case.

In general, Illinois courts have been reluctant to enforce *best efforts* clauses because they are too indefinite and uncertain. On the other hand, Illinois courts have enforced *best efforts* clauses where the parties have expressed objective criteria for determining whether a party has satisfied such an obligation and have refused to enforce mere promises to use *best efforts* where no such criteria exist

The decisions in *Goodman* and *Kraftco* have been cited for the broad premise that *best efforts* clauses are too indefinite and uncertain to be enforceable. In subsequent cases, however, Illinois courts have been reluctant to accept these decisions as the bases for categorically rejecting *best efforts* clauses. As noted above, Illinois courts have established a standard for enforcing *best efforts* clauses, requiring objective criteria to be set forth by the parties by which performance of such an obligation may be measured.

* New York

Under New York law, there appears to be a divergent line of cases addressing the enforceability of *best efforts* clauses. On one hand, courts have recognized the validity of *best efforts* clauses in the absence of articulated objective criteria by which efforts may be measured.

Alternatively, courts have refused to enforce *best efforts* clauses unless the relevant agreement contains clear, objective guidelines against which to measure a party’s performance

As exemplified by the foregoing cases, under New York law, courts will enforce *best efforts* clauses under varying standards. To ensure that such a provision will be enforced, parties should set forth clear, objective criteria against which a party’s performance may be measured.

* Delaware

As in Missouri, there is very little case law in Delaware regarding *best efforts* clauses. In the few decisions on the subject, courts there have acknowledged the rights of parties to enter into such agreements and have enforced *best efforts* provisions where the promisor has satisfied a certain minimum standard of performance.

Delaware courts “do not define the precise contours of the duty of *best efforts*” but citing standards established in other juris- dictions, the court held that a consul- tant’s contractual obligation to use her *best efforts* required her to pursue her duties “with diligence, in good faith, and with reasonable effort.”

The foregoing cases indicate that Delaware courts will enforce *best ef- forts* clauses where parties can show that they have undertaken substan- tive steps to meet such an obligation. Unlike some courts in Illinois and New York, the Delaware courts do not require that the parties set forth clear, objective criteria for determin- ing whether a party has taken such steps, but inclusion of such criteria in an agreement would add certainty and predictability to any such con- tract.

* **Application**

When negotiating and drafting agreements where one or more of the parties is required to exercise their *best efforts*, it is important to include objective criteria by which performance of such obligation may be measured. Under the law of each of the states referenced above, unless such criteria are set forth, parties risk losing the benefit of their bargain as courts may ascribe an unintended meaning to the phrase or an unanticipated standard for fulfilling an obligation to use *best efforts*, or, courts may decline to enforce such a provision altogether on the basis that it is too vague or indefinite.

To avoid these unintended con- sequences, drafters should include clear, objective and measurable criteria for meeting an obligation to exercise *best efforts*; for example, an agreement should contain a dead- line by which the obligation must be performed. If possible, the con- tract should set forth specific actions that parties will endeavor to take to comply with the clause. Conversely, if there are certain actions which a party refuses to take or would not be expected to take, they should be carved out of the required criteria. The parties should consider comparable transactions, prior history, and industry standards to set forth specific objectives that, if met, would evidence a party’s *best efforts*.

By setting forth objective criteria for satisfying *best efforts*, parties will ensure a clear understanding of their rights and obligations under an agreement and increase the likelihood that such agreement will be enforced as intended by each of the parties.

**Is There A Duty Of Good Faith In Construction Contracts? , Last Updated: 5 June 2008, Article by**[**Charlene Linneman**](http://www.mondaq.com/content/author.asp?article_id=61500&author_id=387748)**,**

 The rise of the use of partnering contracts and other contracts such as the NEC that expressly refer to phrases such as 'mutual trust and co-operation' and 'good faith' has turned the spotlight onto the general obligations of parties to construction contracts towards each other. In particular, do parties owe each other an implied duty of good faith when performing their rights and obligations pursuant to a contract that does not expressly refer to 'mutual trust and co-operation' or 'good faith'?

Good faith can be defined in many different ways. It incorporates both subjective elements by requiring honesty and objective elements by requiring adherence to standards of fair dealing. Variations in the meaning of good faith occur between different legal systems due to cultural and geographical differences. In England and Wales, it is often criticised for being a nebulous and vague concept and it has been stated that instances of bad faith are more easily recognisable than good faith.

English judges have on occasion attempted to define good faith. Generally good faith is taken to mean fair play and open dealing. Lord Justice Bingham (as he then was) in Interfoto Picture Library Ltd v Stilleto Visual Programmes Ltd defined good faith as "in essence a principle of fair and open dealing". The parties 'should not deceive each other' with obligations to 'play fair', 'come clean', or 'put one's cards on the table'.

On a European basis, the Lando Commission's Principles of European Contract Law defines good faith to mean 'honesty and fairness in mind, which are subjective concepts'. An Australian Judge, Mr Justice Miller in Bond Corporation Pty Ltd v the Western Australian Planning Commission defined good faith as having two divergent meanings: "*The first is a broad or subjective view which requires inquiry into the actual state of mind of the person concerned & The second involves the objective construction of the words by the introduction of such concepts as an absence of reasonable caution and diligence*."

Some Common Law jurisdictions such as Canada and various states of Australia recognise an implied duty of good faith in contractual performance. For example, the Supreme Court of Victoria, Australia, in the 2007 case of Kellogg Brown & Root Pty Ltd v Australian Aerospace Ltd ruled that the principles of good faith may apply to the operation of a termination for convenience clause present in the parties' contract.

Good faith is also recognised in many civil law countries such as France, Germany and the Netherlands. In these countries, the civil Codes govern the parties' obligations towards each other. For example, the German Civil Code provides at §242 that: "*The debtor is bound to perform according to the requirements of good faith, ordinary usage being taken into consideration*."

With the exception of contracts that are *uberrimae fidei* ("utmost [good faith](http://en.wikipedia.org/wiki/Good_faith)") such as insurance contracts, English law does not yet recognise an implied duty of good faith in the performance of contracts. Part of the court's reluctance to introduce a duty of good faith is because of the nebulous nature of the concept of good faith. The court also adheres to the principles of freedom of contract i.e. parties are free to contract on their own terms as far as possible and these agreements should be upheld and enforced by the courts.

However, parties sometimes include terms in their contracts that embody good faith concepts. In the context of construction contracts, the Technology and Construction Court considered a good faith clause when considering a project manager's duty of impartiality in administering a contract in Costain Ltd v Bechtel Ltd. In this case, the claimant and defendants were working on the Channel Tunnel High-Speed Rail Link. One of the contract recitals provided that: "*The Employer, the Contractor and the Project Manager act in the spirit of mutual trust and co-operation and so as not to prevent compliance by any of them with the obligations each is to perform under the Contract*."

Costain sought an injunction to restrain Bechtel from instructing, persuading or otherwise encouraging any employee, servant or agent of Bechtel or an associated company to seek to operate the assessment and certification functions of the project manager otherwise than impartially and in good faith. The evidence showed that Bechtel staff were advised to exercise their functions under the contract in the interests of the employer and not impartially. In obiter, Mr Justice Jackson referred to the use of the phrase "good faith" in the contract and stated that it was sometimes used as a synonym for impartially and sometimes as a synonym for honestly. In the context of certification, the Judge did not believe a debate about the meaning of the phrase "good faith" would serve a useful purpose. Therefore, the judgement concentrated on whether there was a duty of impartiality and whether it was arguable that this duty had been breached. The Judge believed that it was arguable that the duty had been to act impartially as between employer and contractor when the project manager was assessing sums payable to the contractor. However, an interim injunction was not granted.

This is the only case that has come before the courts considering the good faith obligations in the NEC3 contract. The court did not expressly consider the nature of the obligations of good faith and what the term 'mutual trust and co-operation' requires in the context of a construction contract. In particular, whether it required anything more from the parties than what they were required to do under 'conventional' construction contracts that do not import the obligations of good faith expressly into a construction contract. Therefore, the court actually shied away from such a discussion.

Rather than adopt a broad overarching principle such as good faith, the English courts have instead adopted solutions to unfair situations presented to them. For example, in relation to construction contracts, courts will commonly imply terms into the party's contract to remedy unfair situations on the basis of the parties' presumed intention. One example is that the contractor must do all work under the contract with proper skill and care. In the case of Balfour Beatty v Docklands Light Railway, Counsel for the employer accepted without reservation that an employer was not only bound to act honestly but also bound by contract to act fairly and reasonably, even when no such obligation was expressed in the contract. This concession was accepted by the Court of Appeal. This concession remedied a potentially unfair situation in the Contract.

Despite English court's reluctance to imply a general duty of good faith, they will interpret and give effect to express references to good faith in contracts. For example, in the case of Berkeley Community Villages Ltd, Berkeley Group plc v Fred Daniel Pullen, Kathleen Marguerite Pullen and Alan John Pullen¸ the parties' contract contained a term that the parties would act in the "utmost good faith". This was held to impose a contractual obligation to observe reasonable commercial standards of fair dealing in accordance with their actions which related to the relevant Agreement and also required faithfulness to the agreed common purpose and consistency with the justified expectations of the claimants.

Conclusion

Despite the rise of the use of construction contracts referring to good faith concepts, a decision on the interpretation of a good faith clause in a construction contract is awaited**. However, although there is no implied duty of good faith in construction contracts, the courts have found solutions to unfair (or bad faith) situations that have been presented to them. In this way, the courts have implemented incremental solutions to these situations rather than adopting a broad overarching good faith principle.** Until a decision is forthcoming on the interpretation of good faith clauses, whether there is a difference between the court's previous solutions to unfair situations that currently apply to 'conventional' contracts and good faith contracts remains to be seen.

**INCOTERMS,** [**http://www.iccwbo.org/products-and-services/trade-facilitation/incoterms-2010/the-incoterms-rules/**](http://www.iccwbo.org/products-and-services/trade-facilitation/incoterms-2010/the-incoterms-rules/)

The Incoterms rules have become an essential part of the daily language of trade. They have been incorporated in contracts for the sale of goods worldwide and provide rules and guidance to importers, exporters, lawyers, transporters, insurers and students of international trade.

Incoterms rules have traditionally been used in international sale contracts where goods pass across national borders. In various areas of the world, however, trade blocs, like the European Union, have made border formalities between different countries less significant. Consequently, the subtitle of the Incoterms 2010 rules formally recognizes that they are available for application to both international and domestic sale contracts. As a result, the Incoterms 2010 rules clearly state in a number of places that the obligation to comply with export/import formalities exists only where applicable. Two developments have persuaded the ICC that a movement in this direction is timely. Firstly, traders commonly use Incoterms rules for purely domestic sale contracts. The second reason is the greater willingness in the United States to use Incoterms rules in domestic trade rather than the former Uniform Commercial Code shipment and delivery terms.

**Understanding Incoterms - handy guide to Incoterms,** [**http://www.inboundlogistics.com/cms/article/understanding-incoterms/**](http://www.inboundlogistics.com/cms/article/understanding-incoterms/)

* *a handy guide to Incoterms, a set of international rules for the interpretation of the most commonly used trade terms. Applying Incoterms to sale and purchase contracts makes global trade easier and helps partners in different countries understand one another.*

When global companies enter into contracts to buy and sell goods they are free to negotiate specific terms. These terms include the price, quantity, and characteristics of the goods. Every international contract also contains what is referred to as an Incoterm, or international commercial term.

There are 13 main terms and several secondary terms that denote the points at which shipper, carrier, and consignee risk and responsibility start and end.

The parties to the transaction select the Incoterms, which determine who pays the cost of each transportation segment, who is responsible for loading and unloading of goods, and who bears the risk of loss at any given point during an international shipment. Incoterms also influence customs valuation basis of imported merchandise.

The International Chamber of Commerce in Paris oversees and administers Incoterms, and they are adhered to by the major trading nations of the world. The ICC first published this set of international rules in 1936 as "INCOTERMS 1936." Incoterms are amended every 10 years.

There are currently 13 Incoterms in use, and they are described below. Ex-works, Free on Board, Cost Insurance Freight, and Delivery Duty Paid are the most frequently used Incoterms.

Incoterms are recognized globally by courts and other authorities. Frequently, parties to a contract are unaware of the different trading practices in their respective countries. This lack of knowledge can lead to misunderstandings and disputes between customer and supplier. The incorporation of Incoterms in international sales contracts reduces this risk.

Group E (Departure)

**EXW: EX-WORKS**

The seller, or exporter, makes the goods available to the buyer, or importer at the seller's premises. The buyer is responsible for all transportation costs, duties, and insurance, and accepts risk of loss of goods immediately after the goods are purchased and placed outside the factory door.

The Ex-Works price does not include loading goods onto a truck or vessel, and no allowance is made for clearing customs.

If FOB is the customs valuation basis of the goods in the country of destination, the transportation and insurance costs from the seller's premises to the port of export must be added to the Ex-Works price.

Under EXW, sellers minimize their risk by making the goods available at their factory or place of business.

Group F (Main Carriage Not Paid By Seller)

**FAS: FREE ALONGSIDE SHIP**

Sellers transport the goods from their place of business, clear the goods for export, and place them alongside the vessel at the port of export, where the risk of loss shifts to the buyer. The buyer is responsible for loading the goods onto the vessel, unless specified otherwise, and for paying all costs involved in shipping goods to the final destination.

**FCA: FREE CARRIER**

The seller, or exporter, clears the goods for export and delivers them to the carrier and place specified by the buyer.

If the place chosen is the seller's place of business, the seller must load the goods onto the transport vehicle; otherwise, the buyer is responsible for loading the goods. The buyer assumes risk of loss from that point forward and must pay for all costs associated with transporting the goods to the final destination.

**FOB: FREE ON BOARD**

The seller, or exporter, is responsible for delivering the goods from its place of business and loading them onto the vessel at the port of export, as well as clearing customs in the country of export.

As soon as the goods cross the "ships-rails" (the ship's threshold) the risk of loss transfers to the buyer, or importer. The buyer must pay for all transportation and insurance costs from that point, and must clear customs in the country of import.

An FOB transaction will read "FOB, port of export." For example, assuming the port of export is Boston, an FOB transaction would read "FOB Boston." If CIF is the customs valuation basis, international freight and insurance must be added to the FOB value.

Group C (Main Carriage Paid By Seller)

**CFR: COST AND FREIGHT**

The seller, or exporter, is responsible for clearing the goods for export, delivering the goods past the ships rail at the port of shipment, and paying international freight charges. The buyer assumes risk of loss once the goods cross the ship's rail, and must purchase insurance, unload the goods, clear customs, and pay for transport to deliver the goods to their final destination.

If FOB is the customs valuation basis, the international freight costs must be deducted from the CFR price.

**CIF: COST, INSURANCE AND FREIGHT**

The seller, or exporter, is responsible for delivering the goods onto the vessel of transport and clearing customs in the country of export. The exporter also is responsible for purchasing insurance, with the buyer (importer) named as the beneficiary.

Risk of loss transfers to buyer as the goods cross the ship's rail. If these goods are damaged or stolen during international transport, the buyer owns the goods and must file a claim based on insurance procured by the seller. The buyer must clear customs in the country of import and pay for all other transport and insurance in the country of import.

CIF can be used as an Incoterm only when the international transport of goods is at least partially by water. If FOB is the customs valuation basis, the international insurance and freight costs must be deducted from the CIF price. A CIF transaction will read CIF, port of destination.

For example, assuming that goods are exported to the Port of Los Angeles, a CIF transaction would read "CIF Los Angeles."

**CPT: CARRIAGE PAID TO**

The seller, or exporter, clears the goods for export, delivers them to the carrier, and is responsible for carriage costs to the named place of destination. Risk of loss transfers to the buyer once the goods are transferred to the carrier and the buyer must insure the goods from that time on.

If FOB is the customs valuation basis, the international freight cost must be deducted from the CPT price.

**CIP: CARRIAGE AND INSURANCE PAID TO**

The seller transports the goods to the port of export, clears customs, and delivers them to the carrier. From that point, risk of loss shifts to the buyer. The seller is responsible for carriage and insurance costs to the named place of destination. The buyer is responsible for all costs, and bears risk of loss from that point forward.

If FOB is the customs valuation basis, international freight and insurance costs need to be deducted from the CIP price.

Group D (Arrival)

**DAF: DELIVERED AT FRONTIER**

The seller, or exporter, is responsible for all costs involved in delivering the goods to the named point and place at the frontier (the border between the two countries). Risk of loss transfers at the frontier. The buyer must pay the costs and bear the risk of unloading the goods, clearing customs, and transporting the goods to the final destination.

If FOB is the customs valuation basis, the international insurance and freight costs must be deducted from the DAF price.

**DES: DELIVERED EX-SHIP**

The seller, or exporter, is responsible for all costs involved in delivering the goods to a named port of destination. Upon arrival, the goods are made available to the buyer, or importer, on board the vessel. The seller is responsible for all costs and risk of loss prior to unloading at the port of destination.

The buyer, or importer, must have the goods unloaded, pay duties, clear customs and provide inland transportation and insurance to the final destination.

**DEQ: DELIVERED EX-QUAY**

The seller, or exporter, is responsible for all costs involved in transporting the goods to the wharf (quay) at the port of destination. The buyer must pay duties, clear customs, and pay the cost and bear the risk of loss from that point forward.

If FOB is the customs valuation basis, the international insurance and freight costs, in addition to unloading costs, must be deducted from the DEQ price.

**DDU: DELIVERED DUTY UNPAID**

The seller, or exporter, is responsible for all costs involved in delivering the goods to a named place of destination where the goods are placed at the disposal of the buyer. The buyer, or importer, assumes risk of loss at that point and must clear customs, pay duties, and provide inland transportation and insurance to the final destination.

**DDP: DELIVERED DUTY PAID**

The seller, or exporter, is responsible for all costs involved in delivering the goods to a named place of destination and for clearing customs in the country of import.

Under a DDP Incoterm, the seller provides literally door-to-door delivery, including customs clearance in the port of export and the port of destination. Thus the seller bears the entire risk of loss until goods are delivered to the buyer's premises.

A DDP transaction will read "DDP named place of destination." For example, assuming goods imported through Baltimore are delivered to Silver Spring, the Incoterm would read "DDP, Silver Spring."

If CIF is the customs valuation basis, the costs of unloading the vessel, clearing customs, and delivery to the buyer's premises in the country of destination—including inland insurance—must be deducted to arrive at the CIF value.

*Rules of the Road*

***A)*** *It is the seller's primary duty to deliver the goods on board the vessel named by the buyer at the named port of shipment on the date or within the period stipulated and in "the manner customary at the port." The parties in these circumstances have to follow the custom of the port regarding the actual measures to be taken in delivering the goods onboard. Usually the task is performed by stevedoring companies, and the practical problem normally lies in deciding who should bear the costs of their services.*

***B)*** *A special agreement has to be made to establish who is responsible for "trimming" or "lashing and securing."*

***C)*** *A special agreement has to be made to establish who actually pays import duty and/or other import taxes.*

**Reasonableness standard,** [**http://www.adamsdrafting.com/reasonableness-and-good-faith-in-contracts/**](http://www.adamsdrafting.com/reasonableness-and-good-faith-in-contracts/)

 In my [**recent post on moral turpitude**](http://www.koncision.com/charlie-sheen-and-moral-turpitude/), I noted that I found odd the phrase “its reasonable but good faith opinion.” I thought I should take a more general look at the relationship between those two concepts.

In [**this post**](http://www.koncision.com/using-reasonable-and-reasonably-in-contracts/), I considered a side issue—use of *reasonable* and *reasonably*. Now it’s time to address the main questions: When should you use a reasonableness standard and when should you use a good-faith standard? And does it make sense to use both in a given provision?

***Whether to Use a Reasonableness Standard or a Good-Faith Standard***

As a general matter, I prefer to have a reasonableness standard rather than a good-faith standard apply to the other side in a transaction. A reasonableness standard is objective—what would a reasonable person have done in the circumstances? By contrast, a good-faith standard is subjective—did the party in question think it was acting reasonably, regardless of whether it was or not when viewed from the perspective of a reasonable person? It seems counterproductive to give the other party room to act unreasonably but in good faith.

Of course, the difference between a reasonableness standard and a good-faith standard can be more apparent than real. Often it’s impossible to determine what a contract party was thinking when it acted a given way—either you have no evidence on that score, or the evidence you have is self-serving. So courts often end up deciding whether a party acted in good faith by considering how others have behaved in similar circumstances—in other words, by in effect applying a reasonableness standard. But I’d prefer to apply a reasonableness standard explicitly rather than have it applied by default.

So in the following extracts culled from EDGAR, I’d replace the good-faith standard with a reasonableness standard:

“and shall *make a good faith effort* [read *use reasonable efforts*] to accommodate the Consultant’s reasonable scheduling needs in coordinating such cooperation

provided, however, that any such tax, assessment, charge or levy need not be paid if the validity thereof is being *contested in good faith* [read *reasonably contested*] by appropriate proceedings

unless the Company has *in good faith* [read *reasonably*] determined that the matters relating to such notice do not constitute material, nonpublic information

any written notice, instruction, instrument, statement, request or document that the Escrow Agent *believes in good faith* [read *reasonably believes*] to be genuine”

But I can think of two contexts where a good-faith standard would be appropriate:

First, a good-faith standard is appropriate to qualify an obligation to negotiate. Because a good-faith standard is built into every contract through the implied duty of good faith (see *MSCD* 2.112), an explicit good-faith standard in this context should be redundant. But it’s standard, perhaps because (1) it reinforces the notion that you’re only required to negotiate as long as a meeting of the minds is possible and (2) it makes it clear that a reasonableness standard doesn’t apply—you can’t be forced to agree to something just because a reasonable person in your position would have done so.

And second, a good-faith standard is appropriate when you want to make it clear that the discretion granted a party in a given context is subject to an obligation to act in good faith. Courts in some jurisdictions have held that if Acme is authorized to do something and the provision uses “at its sole discretion” or comparable language, that discretion isn’t subject to the implied duty of good faith. For purposes of contracts governed by the laws of any of those jurisdictions, you should consider either (1) cutting back any grant of discretion that could be construed as particularly open-ended or (2) making it clear that it’s subject to a good-faith standard. (This is something that I’ll soon be writing about at greater length.)

And of course, if your client is the one subject to a given provision, you might want to use the less-exacting good-faith standard.

***Using Both Standards Together***

What about combining the two standards? I think it makes no sense to do so. If you meet the more exacting reasonableness standard, what could be the point of invoking good faith? Consider the following examples:

and it continues to actively employ~~, in good faith,~~ all reasonable efforts to cause the applicable Registration Statement to become effective

the amount of all taxes paid … (as determined reasonably ~~and in good faith~~ by a Financial Officer)

makes it inappropriate in the reasonable ~~good-faith~~ judgment of the indemnified party for the same counsel to represent both the indemnified party and the indemnifying party

**What is a Reasonable Time for Review of Submitt,** [**http://constructionadvisortoday.com/2010/10/what-is-a-reasonable-time-for-review-of-submittals.html**](http://constructionadvisortoday.com/2010/10/what-is-a-reasonable-time-for-review-of-submittals.html)

 Submittal, review and approval of shop drawings, descriptive literature, samples and other information is an inherent part of construction. For contractors, the process poses the risk of delay. Sometimes the contractor cannot proceed with the work without a response from the project owner or its representative. How much time should be allowed before it becomes a compensable delay?

Construction contracts seldom stipulate the amount of time allowed for turn-around of submittals. This is understandable because submittals vary greatly in their complexity. Most contracts simply state a standard of reasonableness. The AIA documents refer to “such reasonable promptness as to cause no delay to the Work.” Other contract forms use similar language.

Faced with this vague standard, courts and administrative boards have come down all over the place. In one case, ten to 12 weeks was deemed reasonable. In another, anything more than 14 days was considered unreasonable. Obviously there is no clear standard and no predictability in this matter.

I invite your comments. Should construction contracts specify a number of days for submittal turn-around or is that not feasible given the wide variety of submittals which must be reviewed? If the standard is simply reasonableness, what is the range of time to be allowed? Twelve weeks seems absurd, but 14 days could be very tight for review of many types of submittals.

[**Reasonableness, Honesty and Good Faith**](http://www.trans-lex.org/124900#toc-1)**, Peter Jones**

The common law has long recognised that traders may act honestly but still be unreasonable. There has been no general obligation in the common law of the British Commonwealth cast an -traders to behave towards each other with good faith in every aspect of their dealings. There are some specific classes of contract which require good faith, and, for instance, insurance contracts require parties to act towards each other with the upmost good faith because of the contracts being based an knowledge solely in the knowledge of the proposer or insured. It is true that over a wide range of duties in contract as well as tort the common law has implied obligations of reasonableness in conduct.

The Australian case of *Renard Constructions (ME) Pty Ltd v Minister for Public Works*1 contains an interesting discussion by Priestley JA of the question of the exercise of contractual powers reasonably, compared with their exercise honestly, and compared with the concept of good faith relative to considerations of reasonableness.

(…)

After further discussion of the development of the principle in the United States, His Honour noted the comment of the Ontario Law Reform Commission in its Report an Amendment of the Law of Contract' of 1987 that: ". . . while good faith is not yet an openly recognised contract law doctrine, it is very much a fact in everyday contractual transactions. To the extent that the common law of contracts, as interpreted and developed by our Courts, reflects this reality, it is accurate to state that good faith is a part of our law of contracts.

'In this vein, a great many well-established concepts in contract law reflect a concern for good faith, fair dealing and the protection of reasonable expectations, creating a legal behavioural baseline

(…)

It may be argued that there are circumstances where failure to act in good faith could comprise misleading and deceptive conduct in contravention of those statutes. The fact, however, that the legislature in each of Australia and New Zealand has seen fit to record that such behaviour is unlawful, where previously it was not necessarily so at common law (and certainly not in such broad terms), is a further indication of the widening scope of general obligations being imposed by Australian and New Zealand contract and sales law.

<http://www.trans-lex.org/124900>

**Fiche Class 5**

**General principles influencing the interpretation and application of contract clauses**

**Divining the Meaning of Best Efforts** (Jonathan Pink)

A "best efforts" clause must be one of the most misunderstood provisions to consistently worm its way into an agreement.

**Interpreting best efforts**

Whether you are in actual legal breach of your agreement depends on what is required of a party who promises to use its best efforts. Your answer might be: doing everything in your power to achieve the contract's objective.

To interpret a clause, you can refer to:

* Statutory requirements: though your interpretation may sound reasonable, it is also true that every contract already contains an implied covenant of good faith and fair dealing.
* Contractual language: look at the letter of the agreement to discern exactly what you are required to do.
* Case law: but it is still an unsettled matter in case law.
  + *United Telecommunications Inc v. American Television & Communications Corp* (Second Circuit – 1976): held that, as between commercial parties, a best effort clause is intended to impose a duty beyond a good faith, duly diligent performance of the contract.
  + Other case law (*Krinsky* 2002): “the plain meaning of the term denotes efforts more than usual or even merely reasonable”.
* Code provisions: Uniform Commercial Code (UCC) states that “best efforts” is a more rigorous standard than “good faith”.
  + Case law (*Martin* 2001): a best efforts clause necessarily depends on the factual circumstances surrounding the agreement.
* Industry practice: this can serve as a gauge for determining whether efforts are sufficiently ‘best’ to defeat a claim for breach. But this assumes that industry standards can be identified.

**Practical pointers**

Because of the uncertainty surrounding the legal effect of a best efforts promise, the best approach appears to be treating these clauses as unenforceable if they lack any objectively measurable standards.

* Case *Pinnacle* (1981): absent an objective criteria by which to measure performance, “best efforts” clauses are so vague as to be unenforceable.
* Specifically, the judges held that “*best efforts and similar clauses, like any other contractual agreement, must set forth in definite and certain terms every material element of the contemplated bargain*” and also “*essential to the enforcement of a best efforts clause is a clear set of guidelines against which the parties best efforts may be measured*”.
* “*Thus absent express standards, a court cannot decide that one party’s offer does not constitute its best efforts; nor can it say that the other party’s refusal to accept certain terms does not constitute its best efforts.*”

It means that if the parties are intent on including a best efforts clause, they must clearly define for themselves within the body of the agreement precisely what this means and how it will be measured. They need to set guidelines a court can use to determine what was required by the promisor and whether those requirements were met.

* Standing alone, its meaning is nebulous and its enforceability tenuous.

**Understanding “Best efforts” and its variants – K. Adams**

This article recommends that if you provide in a contract that a party is subject to an *efforts* standard, generally you should specify by means of a defined term what sort of actions would satisfy that requirement.

Function of best efforts provisions: when accomplishing a certain goal is not entirely within Acme’s control, Acme would generally not be willing to enter into a contract that makes it Acme’s absolute duty.

* Doing so would pose a **risk of future liability for nonperformance**

There are several variants of “best efforts”, the most common are:

* Commercially reasonable efforts
* Reasonable best efforts
* Reasonable efforts.

Lawyers generally think that a best efforts provisions means that the promisor is required to do everything in its power to accomplish the goal, even if it bankrupts itself in the process – while other *efforts* standards are less onerous.

What does Case law say about it?

* Courts have not required that a party under a duty to use best efforts to accomplish a given goal make every conceivable effort to do so regardless of the detriment to it.
* “*Best efforts cannot mean everything possible under the sun*” (Triple-A, 1st Cir, 1987)
* Some courts have held that the appropriate standard is one of good faith ; “we have been unable to find any case in which a court found that a party acted in good faith but did not use its best efforts”.
* But more recent cases have held that the standard is higher than that of good faith (“*Best efforts requires more than good faith which is an implied covenant in all contracts*”).
* Official comment to UCC: the implied obligation to use best efforts requires that parties “*use reasonable diligence as well as good faith in their performance of the contract*”).

The “*efforts”* variants mostly mean the same thing:

* Most courts use the term best efforts and reasonable efforts interchangeably.

**Determining whether a party has made sufficient efforts**

Equating best efforts with diligence or reasonableness does not change its ambiguous character. The result of this vagueness is that determining whether a party has made sufficient efforts necessarily **depends on the circumstances of the case** with all the uncertainty that entails.

Establishing a benchmark

Determining whether a party has complied with an *efforts* provision is facilitated if the efforts that were actually made can be compared against some **benchmark.** Possible benchmarks:

* Promises made during contract negotiations for guidance on what efforts had been expected.
* Industry practice
* Efforts used by the promisor in connection with other contracts imposing an *efforts* standard.
* How the promisor would have acted if the promisor and promisee had been united in the same entity.

Balancing without a benchmark

In the absence of any such benchmark, a requirement that a promisor use efforts to accomplish a contract goal would likely be balanced against the broader constraints faced by the promisor in conducting the business that is the subject of the contract.

**The enforceability of “*efforts*” provisions**

Courts in most jurisdictions have held that *efforts* provisions are enforceable. The principal exception is Illinois courts, which have held that a promise to use best efforts is too vague to be binding if the parties fail to indicate what performance the phrase requires.

**Defining what “efforts” means**

Confusion as to the meaning of efforts can result in party’s having unrealistic expectations of the performance required of another party that is under an efforts obligation.

The way to avoid these problems would be to specify by contract what sort of efforts must be made by a party that is under an obligation to make efforts to accomplish a particular contract goal. Obvious way would be to create a **defined term**.

According to the author of this article, it is better to use the phrase *reasonable efforts* rather than *best efforts* ; the word best is not conveying the standard meaning of best.

The author recommends the following core definition:

* **Reasonable efforts** means with respect to a given goal, the efforts that a reasonable person in the position of the promisor would use so as to achieve that goal as expeditiously as possible.

Carve-outs

The negotiations regarding the definition of reasonable efforts would mostly concern carve-outs which specify what is excluded from the definition.

* Ex: a carve-out could refer to “any action or expenditure that is disproportionate or unduly burdensome”.
* But it would be better to offset the vagueness of the core definition by making the carve-outs highly specific.

For instance, one could exclude from the definition of reasonable efforts any of the following:

* Out-of-pocket costs, fees and expenses of counsel, taxes and other fees and penalties
* Taking any action that would cause the promisor to incur costs or suffer any other detriment, out of reasonable proportion to the benefits to the promisor under this agreement.
* Incurring any liabilities
* Changing the promisor’s business strategy
* Taking any action that would imperil the promisor’s existence or solvency

**Be clear when using best efforts**

The underlying reasons for using best efforts provisions involve some degree of uncertainty that the parties are attempting to address or mitigate.

* Ex: where the completion of a transaction is contingent on the occurrence of certain conditions, such as securing financing, parties attempt to insure the satisfaction of these conditions by agreeing to exercise their best efforts. Same thing with obtaining regulatory approvals in which case a party will promise to use its best efforts rather than risk the liability of breaching an absolute promise.

The risk to each side, both promisor and promisee, is that neither may be certain what actions will be necessary to satisfy an obligation to use best efforts or whether the provision will be enforceable at all.

* The potential exists for different understandings by parties and varying standards applied by courts leading to unanticipated results.

Application

When negotiating and drafting agreements where one or more of the parties is required to exercise their best efforts, it is important to include objective criteria by which performance of such obligation may be measured.

* Parties risk losing the benefit of their bargain as courts may ascribe an unintended meaning to the phrase or an unanticipated standard for fulfilling an obligation to use best efforts or courts may decline to enforce such a provision altogether on the basis that it is too vague or indefinite.

Drafters should include clear, objective and measurable criteria for meeting an obligation to exercise best efforts. For ex, an agreement should contain a deadline by which the obligation must be performed. If possible, the contract should set forth specific actions that parties will endeavor to take to comply with the clause.

**UK: Is there a duty of good faith in construction contracts?**

Good faith can be defined in any different ways. It incorporates both subjective elements by requiring honesty and objective elements by requiring adherence to standards of fair dealing. Variations occur due to cultural and geographical differences.

English judges have on occasion attempted to define good faith. Generally, good faith is taken to mean *fair play and open dealing*.

* European definition: *honesty and fairness in mind*

- Case law example: Costain v. Bechtel

Justice Jackson referred to the use of the phrase “good faith” in the contract and stated that it was sometimes used as a synonym for impartially and sometimes as a synonym for honestly.

Rather than adopt a broad overarching principle such as good faith, the English courts have instead adopted solutions to unfair situations presented to them. For example, in relation to construction contracts, courts will commonly imply terms into the party's contract to remedy unfair situations on the basis of the parties' presumed intention.

Despite English court's reluctance to imply a general duty of good faith, they will interpret and give effect to express references to good faith in contracts. For example, in the case of *Berkeley Community Villages Ltd, Berkeley Group plc v Fred Daniel Pullen, Kathleen Marguerite Pullen and Alan John Pullen¸* the parties' contract contained a term that the parties would act in the "utmost good faith".

* This was held to impose a contractual obligation to observe reasonable commercial standards of fair dealing in accordance with their actions which related to the relevant Agreement and also required faithfulness to the agreed common purpose and consistency with the justified expectations of the claimants.

**Conclusion:** no implied duty of good faith in construction contracts (in the UK).

**Understanding Incoterms**

International commercial terms. There are 13 main terms and several secondary terms that denote the point at which shipper, carrier and consignee risk and responsibility start and end.

The parties to the transaction select the Incoterms, which determine who pays the cost of each transportation segment, who is responsible for loading and unloading of goods, and who bears the risk of loss at any given point during an international shipment.

Incoterms are recognized globally by courts and other authorities. The incorporation of Incoterms in international sales contracts reduces this risk.

1. **Group E: Departures**

**EXW: EX-WORKS**

The seller, or exporter, makes the goods available to the buyer, or importer at the seller's premises. The buyer is responsible for all transportation costs, duties, and insurance, and accepts risk of loss of goods immediately after the goods are purchased and placed outside the factory door. The Ex-Works price does not include loading goods onto a truck or vessel, and no allowance is made for clearing customs.

1. **Group F: Main Carriage Not Paid By Seller**

**FAS: FREE ALONGSIDE SHIP**

Sellers transport the goods from their place of business, clear the goods for export, and place them alongside the vessel at the port of export, where the risk of loss shifts to the buyer.

**FCA: FREE CARRIER**

The seller, or exporter, clears the goods for export and delivers them to the carrier and place specified by the buyer.

If the place chosen is the seller's place of business, the seller must load the goods onto the transport vehicle; otherwise, the buyer is responsible for loading the goods.

**FOB: FREE ON BOARD**

The seller, or exporter, is responsible for delivering the goods from its place of business and loading them onto the vessel at the port of export, as well as clearing customs in the country of export. As soon as the goods cross the "ships-rails" (the ship's threshold) the risk of loss transfers to the buyer, or importer.

1. **Group C: Main Carriage Paid By Seller**

**CFR: COST AND FREIGHT**

The seller, or exporter, is responsible for clearing the goods for export, delivering the goods past the ships rail at the port of shipment, and paying international freight charges. The buyer assumes risk of loss once the goods cross the ship's rail, and must purchase insurance, unload the goods, clear customs, and pay for transport to deliver the goods to their final destination.

**CIF: COST, INSURANCE AND FREIGHT**

The seller, or exporter, is responsible for delivering the goods onto the vessel of transport and clearing customs in the country of export. The exporter also is responsible for purchasing insurance, with the buyer (importer) named as the beneficiary.

Risk of loss transfers to buyer as the goods cross the ship's rail. If these goods are damaged or stolen during international transport, the buyer owns the goods and must file a claim based on insurance procured by the seller. The buyer must clear customs in the country of import and pay for all other transport and insurance in the country of import.

**CPT: CARRIAGE PAID TO**

The seller, or exporter, clears the goods for export, delivers them to the carrier, and is responsible for carriage costs to the named place of destination. Risk of loss transfers to the buyer once the goods are transferred to the carrier and the buyer must insure the goods from that time on.

**CIP: CARRIAGE AND INSURANCE PAID TO**

The seller transports the goods to the port of export, clears customs, and delivers them to the carrier. From that point, risk of loss shifts to the buyer. The seller is responsible for carriage and insurance costs to the named place of destination. The buyer is responsible for all costs, and bears risk of loss from that point forward.

1. **Group D: Arrival**

**DAF: DELIVERED AT FRONTIER**

The seller, or exporter, is responsible for all costs involved in delivering the goods to the named point and place at the frontier (the border between the two countries). Risk of loss transfers at the frontier. The buyer must pay the costs and bear the risk of unloading the goods, clearing customs, and transporting the goods to the final destination.

**DES: DELIVERED EX-SHIP**

The seller, or exporter, is responsible for all costs involved in delivering the goods to a named port of destination. Upon arrival, the goods are made available to the buyer, or importer, on board the vessel. The seller is responsible for all costs and risk of loss prior to unloading at the port of destination.

**DEQ: DELIVERED EX-QUAY**

The seller, or exporter, is responsible for all costs involved in transporting the goods to the wharf (quay) at the port of destination. The buyer must pay duties, clear customs, and pay the cost and bear the risk of loss from that point forward.

**DDU: DELIVERED DUTY UNPAID**

The seller, or exporter, is responsible for all costs involved in delivering the goods to a named place of destination where the goods are placed at the disposal of the buyer. The buyer, or importer, assumes risk of loss at that point and must clear customs, pay duties, and provide inland transportation and insurance to the final destination.

**DDP: DELIVERED DUTY PAID**

The seller, or exporter, is responsible for all costs involved in delivering the goods to a named place of destination and for clearing customs in the country of import.

Under a DDP Incoterm, the seller provides literally door-to-door delivery, including customs clearance in the port of export and the port of destination. Thus the seller bears the entire risk of loss until goods are delivered to the buyer's premises.

A DDP transaction will read "DDP named place of destination." For example, assuming goods imported through Baltimore are delivered to Silver Spring, the Incoterm would read "DDP, Silver Spring."

If CIF is the customs valuation basis, the costs of unloading the vessel, clearing customs, and delivery to the buyer's premises in the country of destination—including inland insurance—must be deducted to arrive at the CIF value.

1. **Rules of the Road**
2. It is the seller's primary duty to deliver the goods on board the vessel named by the buyer at the named port of shipment on the date or within the period stipulated and in "the manner customary at the port." The parties in these circumstances have to follow the custom of the port regarding the actual measures to be taken in delivering the goods onboard. Usually the task is performed by stevedoring companies, and the practical problem normally lies in deciding who should bear the costs of their services.
3. A special agreement has to be made to establish who is responsible for "trimming" or "lashing and securing."
4. A special agreement has to be made to establish who actually pays import duty and/or other import taxes.

**Reasonableness and good faith in contracts**

When should you use a reasonableness standard and when should you use a good-faith standard? And does it make sense to use both in a given provision?

Whether to use a reasonableness standard or good faith standard?

I prefer to have a reasonableness standard. A reasonableness standard is objective while good-faith is subjective.

* So courts often end up deciding whether a party acted in good faith by considering how others have behaved in similar circumstances – in other words, by in effect applying a reasonableness standard.

But I can think of two contexts where a good-faith standard would be appropriate:

* First, a good-faith standard is appropriate to qualify an obligation to negotiate. Because a good-faith standard is built into every contract through the implied duty of good faith (see *MSCD* 2.112), an explicit good-faith standard in this context should be redundant. But it’s standard, perhaps because (1) it reinforces the notion that you’re only required to negotiate as long as a meeting of the minds is possible and (2) it makes it clear that a reasonableness standard doesn’t apply—you can’t be forced to agree to something just because a reasonable person in your position would have done so.
* And second, a good-faith standard is appropriate when you want to make it clear that the discretion granted a party in a given context is subject to an obligation to act in good faith. Courts in some jurisdictions have held that if Acme is authorized to do something and the provision uses “at its sole discretion” or comparable language, that discretion isn’t subject to the implied duty of good faith. For purposes of contracts governed by the laws of any of those jurisdictions, you should consider either (1) cutting back any grant of discretion that could be construed as particularly open-ended or (2) making it clear that it’s subject to a good-faith standard. (This is something that I’ll soon be writing about at greater length.)

**Combining the two standards makes no sense**.

**What is a reasonable time for review of submittals?**

Submittal, review and approval of shop drawings, descriptive literature, samples and other information is an inherent part of construction. For contractors, the process poses the risk of delay. Sometimes the contractor cannot proceed with the work without a response from the project owner or its representative. How much time should be allowed before it becomes a compensable delay?

Construction contracts seldom stipulate the amount of time allowed for turn-around of submittals. Most contracts simply state a standard of reasonableness. The AIA documents refer to “such reasonable promptness as to cause no delay to the Work.”

**C//: there is no clear standard.**

**Reasonableness, Honesty and Good Faith**

The Australian case of *Renard Constructions (ME) Pty Ltd v Minister for Public Works* contains an interesting discussion by Priestley JA of the question of the exercise of contractual powers reasonably, compared with their exercise honestly, and compared with the concept of good faith relative to considerations of reasonableness.

Cole J held that regardless of what the parties conceded, the cancellation clause did not carry an implied obligation upon the principal to exercise reasonably the power to take over the work and exclude the contractor from the site.

His Honour decided that a requirement of reasonableness in the application of the show cause clause was required under both heads. His Honour then went an to discuss among other things considerations which confirmed his opinion that reasonableness in performance was implied in the particular clause.

* « *The kind of reasonableness I have been discussing seems to me to have had much in common with the notions of good faith which are regarded in many of the civil law systems of Europe and in all States in the United States as necessarily implied in many kinds of contract.* »

Cours 6 - Préparation

**General Information on the NEC model contract**, <https://www.neccontract.com/About-NEC/History>

The first NEC contract – then known as the **'New Engineering Contract'** – was published in 1993. It was a radical departure from existing building and engineering contracts, being written in **plain language** and designed to stimulate rather than frustrate **good management**.

The second edition, called the NEC [**Engineering and Construction Contract**](https://www.neccontract.com/Products/Contracts/Engineering-Construction-Contract), appeared two years later together with a new [**Professional Services Contract**](https://www.neccontract.com/Products/Contracts/Professional-Services-Contract), [**Adjudicator's Contract**](https://www.neccontract.com/Products/Contracts/Adjudicator-s-Contract) and a **back-to-back** set of short forms and sub-contracts.

A decade of extensive international use followed, culminating in the development and launch of the [**NEC3 contract suite**](https://www.neccontract.com/Products/Contracts/NEC3-April-2013-Edition-complete-family-of-contra) in 2005. This included a new [**Term Service Contract**](https://www.neccontract.com/Products/Contracts/Term-Service-Contract) and [**Framework Contract**](https://www.neccontract.com/Products/Contracts/Framework-Contract), joined in 2010 by a [**Supply Contract**](https://www.neccontract.com/Products/Contracts/Supply-Contract)**.**

The suite was updated and enlarged to 39 documents in April 2013, including a [**Professional Services Short Contract**](https://www.neccontract.com/Products/Contracts/Professional-Services-Contract/NEC3-Professional-Services-Short-Contract-PSSC) – the Association for Project Management's **standard form for appointing project managers** – and an enhanced set of guidance documents.

The NEC3 suite is now endorsed by [governments](https://www.neccontract.com/About-NEC/Governments) and [industry](https://www.neccontract.com/About-NEC/Endorsements) worldwide and has an unrivalled track record for delivering projects on time and on budget – including the London 2012 Olympic and Paralympic Games venues.

Interview with NEC creator Martin Barnes CBE and NEC Users' Group Secretary Robert Gerrard.

* Loss of control as a manager before signing the contract with the main manager
  + Inability to react to new circumstances
    - Need for an improvement
  + Motivate everybody who had to play a role to play that role for their own benefit
  + The plan was to write a way of managing the project: describing what the parties did in various situation
* Clarity and simplicity
  + No principle but list of 20 things
    - Short sentences, short words: simple language for people to understand even if not English native speakers
    - Dividing the sections
    - Everything under one topic together
  + A large proportion of litigations and arbitrations regard what the words mean
  + Pre-contract influence
  + Post-contract
* Stimulation for people to work together for the benefit of everybody
* The most important characteristics:
  + Clarity and simplicity
  + Flexibility
  + Stimulus to good management
* The biggest influence was the stimulus to god project management
* Same basic contract for everyone involved
* Development of NEC: process for compensation is too complicated
  + Also need to see if possible to discourage people to amend the NEC
  + No need to broaden its scope
    - Should focus on making the contract work much better

**General Information on the MF1 Conditions of Contract**, <http://www.theiet.org/resources/model-forms/>

Steers to success: the joint IMechE/IET Model Forms of General Conditions of Contract.

Jointly with the Institution of Mechanical Engineers, The IET issues a range of model forms of general conditions of contract and some separate guides (known as ‘commentaries’) to their use.

These are model forms of contract for electrical and mechanical work and consultancy. The contents of these publications are decided by a joint committee of IET/IMechE members and others representing the various interests of the electrical and mechanical engineering industries.

There are four primary publications in the series with associated commentaries. MF/1, MF/2 and MF/4 cover home and overseas contracts; MF/3 is for home contracts only.

**“Home” contracts include those under the laws of England and Wales, Scotland or Northern Ireland.**

[**MF/1 Revision 6**](http://www.theiet.org/resources/books/model/mf1-rev6.cfm)

MF/1 has been revised for the first time since 2010.

Containing clear, simple language designed specifically for engineering projects, Revision 6 contains general conditions that have been adapted over many years to provide assurance for both parties involved with a contract.

[**Commentary on MF/1 Revision 5**](http://www.theiet.org/resources/books/model/110898.cfm)

This Commentary gives users practical help and guidance on the clauses of the MF/1 Revision 5 conditions and the MF/1 Revision 5 contract documents and their interrelationship.

[**MF/2 Revision 1**](http://www.theiet.org/resources/books/model/19013.cfm)

MF/2 is a key industry Model Form of General Conditions of Contract for use in connection with home or overseas contracts for the supply of electrical, electronic or mechanical plant. In addition to its ‘General Conditions’ it also includes sets of additional unique ‘Special Conditions’. This standard form of contract is recommended to be used by contracts officers in private and public sector organisations, mechanical and electrical engineers, facilities managers, lawyers and in-house legal representatives.

[**Commentary on MF/2 Revision 1**](http://www.theiet.org/resources/books/model/18996.cfm)

This Commentary gives users practical help and guidance on the clauses of the MF/2 Conditions and the MF/2 contract documents and their interrelationship.

[**MF/3 Revision 1**](http://www.theiet.org/resources/books/model/19281.cfm)

MF/3 is a key industry Model Form of General Conditions of Contract to cover the main conditions for home contracts for the supply of electrical and mechanical goods –without erection. it is **a lump sum contract intended for use where no initial design or subsequent installation or commissioning is required**. This standard form of contract is recommended to be used by contracts officers in private and public sector organisations, mechanical and electrical engineers, facilities managers, lawyers and in-house legal representatives.

Note that there is no commentary associated with this model form of contract.

[**MF/4**](http://www.theiet.org/resources/books/model/21832.cfm)

MF/4 is a key industry Model Form of Terms and Conditions of Engagement for use as home or overseas agreements for the provision of consultancy services by Engineering Consultants. [MF/4 is available as a free PDF download.](http://www.theiet.org/resources/books/model/mf4-free.cfm)

[**Commentary on MF/4**](http://www.theiet.org/resources/books/model/19415.cfm)

The Commentary gives users practical help and guidance on the clauses of the MF/4 Conditions. MF/4 Model Form is contained within this Commentary.

The history of The IET Model Forms of Contract

It appears that there were no standard forms in use in the electrical/mechanical engineering field prior to those produced by the IEE at the turn of the 20th century. The creation of a model form for electrical works, in 1900-1903, was therefore a response to a real demand. Its appearance was greeted by a complaint that the IEE Council should have "several years earlier endeavoured to remove some of the real grievances shown to be affecting the stability and prosperity of the industry."

A pioneer member, Mr Robert Hammond (1850-1915) was the prime mover in the creation of the first model form.

**General Information on the ICC Model Turnkey Contract for Major Projects**, Herfried Wöss (imprimé: à lire !)

The International Chamber of Commerce (ICC) launched the latest form in its suite of model commercial contracts in 2007. The Model Turnkey Contract for Major Projects includes many aspects familiar from other turnkey contracts but also many innovative features. This article provides a detailed overview of the form and its key aspects.

It consists of a Main Contract Form, Conditions of Contract with 13 Chapters (1. General and Preliminary Articles; 2. The Parties’ Obligations; 3. The Execution of the Project; 4. Design – Responsibility and Management, Variations; 5. Commencement, the Time to Taking Over, Scheduling and Progress; 6. Contract Price and Payment; 7. Completion and Taking Over of the Works by the Employer; 8. Defect Correction Period; 9. Allocation of Risk and Responsibility and Exclusions from Liability; 10. Force Majeure and Termination of the Contract; 11. Insurance; 12. Miscellaneous Provisions; and 13. Claims, Dispute Resolution and arbitration

As the Introduction of the Contract clearly states:

‘There is no uniformly accepted definition of the term “turnkey”. The basic concept is that the contractor shall provide the works ready for use at the agreed price. The reality is that the employer wants to be and should be actively involved in the project at all stages. While this is a turnkey contract, there are articles allowing changes to the contract scope, price and time for completion.’

According to Article 13 of the Contract, the employer is to pay the contract price and not hinder or delay the contractor in the performance of its duties.

The scope of work is exclusively set out in the Contract (Article 20.1). Other matters should be covered by separate agreements.

Save for any provision to the contrary, the Contract will be governed and construed in accordance with the substantive law of the country where the site is located. It goes without saying that the provisions of the Contract have to be carefully examined under the applicable law. Local contractual practices which may have an effect on the interpretation of the Contract in the country where the site is located should be taken into consideration.

Ccl: The ICC Major Projects Contract is, without doubt, an excellent model of a modern international turnkey contract based on an equilibrium of the rights and obligations between the employer and contractor, and a balanced risk allocation. The Contract provides a clear and compact structure that facilitates its administration. The claims management and dispute resolution provisions are straightfor ward. Notification procedures are kept to a necessary minimum.

The Contract should be suitable for use in civil and common law and other jurisdictions. However, as is mentioned in its footnote 4, the ‘parties should check if the provisions of this model contract conform with [the applicable law]’.

**Ambiguities in Contracts – The *Contra Proferentem* Rule,** <http://www.alway-associates.co.uk/legal-update/article.asp?id=128>

Unsurprisingly, a frequent area of dispute in the construction industry (and others) stems from disagreements and differing opinions by the parties as to the true interpretation of a particular contract term i.e. its precise wording and context in the overall contract; ambiguity; poor drafting etc.

Certain ambiguities, errors...may be dealt with by the Contract provisions (e.g. see clause 2.2 and 2.4 of JCT 1998 PWQ dealing with particular errors, discrepancies / divergences). In the absence of provisions in the contract, the general rules of contract interpretation apply.

**Where such a dispute arises, it is the Courts, not the parties, that interpret the contract terms, ascertaining their ‘true meaning’ in order to give effect to the intention of the parties.** The law strives for, and promotes, certainty in agreements. As a general rule a written agreement stands alone as a solitary expression of the parties’ intentions (the “Parol Evidence Rule”). **The parties’ intentions must be ascertained from it**, “***according to the ordinary grammatical meaning of the words used therein***” [*Lovell & Christmas Ltd v Wall* (1911) 104 LT85].

**The Parol Evidence Rule is not absolute**. The Courts also have various rules of interpretation available to assist them in construing the parties intentions *(see Investors Compensation Scheme Ltd –v- West Bromwich Building Society [1998] 1WLR 896. )*

**The *contra proferentem* Rule**

One particular rule of interest applied by the Courts in interpreting contracts, albeit sometimes misunderstood, is the *contra proferentem* Rule.

Importantly, this rule is limited and applies: 1) only to an ambiguity (e.g. where a clause has two or more meanings); and, 2) where **all** other rules of construction have failed to resolve it.

Under this rule, the ambiguous contract term (i.e. two or more meanings) may be interpreted by the Courts against the profferer (the person who drafted / tendered the document to the other contracting party), applying an interpretation of the contract term which is most favourable to the other party.

The rule is also applied by the Courts to exclusion, indemnity and other similar clauses i.e. liquidated damages clauses [*Miller v LCC* (1934) 50 T.L.R. 479; *Peak Construction (Liverpool) Ltd v McKinney Foundations Ltd* (1970) 1 B.L.R. 111]. Such provisions are strictly construed against the person relying on them. This is not dealt with further or in any detail in this article.

In construction contracts this rule is more likely to apply to one party’s unilateral terms i.e. bespoke construction contracts / bespoke amendments to standard forms of contract. These often seek to give a distinct advantage to the profferer over the other party.

However it is doubtful that this rule would be applied to un-amended industry recognised standard forms of Contract (e.g. as published by the JCT / ICE etc). Whilst selected for use by the Employer, these are not unilateral, being negotiated by representatives from all sides of the industry. Both Keating [*See 3-331; Keating on Building Contracts, 7th Edition (Sweet & Maxwell)*] and Hudson [*Hudson Building and Engineering Contracts, 11th Edition (Sweet & Maxwell)*] support this view.

**In summary, those drafting or amending contracts need to ensure that they incorporate terms which are concise and unambiguous, preferably in plain, intelligible language**. Otherwise, if there is doubt about the meaning of a written term, they may find that an interpretation more favourable to the other party is applied, in appropriate circumstance. This may be contrary to their intentions, and in certain circumstances, could be financially disastrous.

If in any doubt when drafting / amending contracts you should seek legal advice.

**Drafting contracts: guidance on managing ambiguity**, DLA Piper, <http://www.mondaq.com/australia/x/163072/Contracts+Deeds/Drafting+contracts+guidance+on+managing+ambiguity>

**In an ideal world, the wording of contracts would be clear, easy to read and unambiguous**. Ambiguity in contracts leads to disputes about the intended meaning or interpretation where one or both parties assert that more than one interpretation is possible. It is an unfortunate fact, however, that despite the efforts of even the best contract drafter, no contract will be perfectly clear, and every contract will contain some ambiguity.

Chief Justice Knox of the High Court of Australia has described this by saying that "***experience shows that the words of many, if not most, documents are capable... of more than one meaning.****"* Accordingly, it is essential that ambiguity is managed effectively. For example, special provisions may be inserted into a contract to ensure that in interpreting ambiguous clauses, the meaning which best favours one or other of the contractual parties is the one which is ultimately adopted. This article provides guidance as to how the courts resolve ambiguity and how parties may best manage ambiguity in contracts.

**Golden rule**

When the courts adjudicate disputes about the meaning of an ambiguous provision, they generally apply the so-called "golden rule".

This rule requires the court to take the following steps:

1. Determine the **ordinary and natural meaning** of the words used in the provision
2. **Consider the context of the contract**, which includes matters such as the purpose of the contract, any "recitals" or "background" clauses, and any other relevant provisions of the contract
3. **If the ordinary and natural meaning is inconsistent** with the context of the contract, or if it gives rise to any absurdities, **modify the meaning as appropriate**.

The meaning derived by this method, in the vast majority of cases, will be adopted by the courts.

***Contra proferentem rule***

In a minority of cases, however, the courts will consider that the ambiguity is so great that it cannot be resolved by the above method. In these cases, the courts may resort to the so called "***contra proferentem* rule**". **This rule states that the ambiguity should be interpreted against**:

* **The party who prepared the contract** (eg for standard form contracts, which are usually offered on a "take it or leave it"' basis); or
* **The party who seeks to rely on the ambiguous provision** (eg the beneficiary of a guarantee, indemnity, limitation or exclusion provision).

To illustrate, the head contractor (Contractor X) of construction works might indemnify the principal who commissioned the works (Principal Y) with respect to "**any damage**" incurred by Principal Y in connection with the carrying out of the building works. Assume that a wall collapsed on a passer by, who sued Principal Y and received an award of damages for personal injury. Principal Y may seek to rely on the indemnity given by Contractor X. Contractor X may dispute that "**damage**", as opposed to "**damages**", referred to property damage rather than court-awarded damages. If this dispute were to be determined by a court, it is likely that Contractor X's interpretation would be adopted. This is because the formulation of the contra proferentem rule requires the word "damage" to be interpreted against the interests of Principal Y, the party seeking to rely on the indemnity.

**Contracting out of the *contra proferentem* rule**

In the example given above, a different outcome may have been reached if the contract contained the following provision, or similar:

*"In the interpretation of this contract or any part of it, no rule of construction shall apply to the disadvantage of any party on the basis that that party:*

1. *Prepared this contract or any part of it; or*
2. *Seeks to rely on this contract or any part of it."*

Such a provision was considered by the Court of Appeal of New South Wales in the case of *GL Nederland (Asia) Pty Limited v Expertise Events Pty Limited* (1999) NSWCA 62. In that case, a wholesale distributor of jewellery was exhibiting its jewellery at Darling Harbour, Sydney when one of its suitcases containing jewellery was stolen. The distributor sued the organiser of the exhibition (with whom it had a contract) for negligence. The organizer attempted to rely upon a clause in the contract excluding all ***"responsibility or liability whatsoever for damages to exhibits".*** (The suitcase of jewellery was found to be an "exhibit".)

The Court of Appeal considered that the meaning of the exclusion clause, although not easy to determine, was unambiguous. Accordingly, there was no scope for the contra *proferentem* rule to apply. However, Giles JA (Spigelman CJ and Beazley JA agreeing) noted that even if the clause was ambiguous, *"I see no reason why the parties should not have agreed, as they did in cl1(e), upon appropriate rules for construction of their contract, including negating the contra proferentem rule."* **In other words, in this case the judges determined that the parties were free to contract out of the rule by using clauses such as that set out above**.

Of course, parties must determine whether or not contracting out of the contra proferentem rule best serves their interests. In the example given above, Contractor X would be well advised to resist any contracting out, because the rule could only work in its favour. Conversely, Principal Y, who seeks to rely on the indemnity, would be advised to negotiate for contracting out of the rule. Similarly, parties who put forward standard form contracts on a "**take it or leave it**" basis (eg banks, insurers and other large service providers) should, in most cases, seek to contract out of the rule.

**Approach in other jurisdictions**

The approach taken by the Court of Appeal in the GL Nederland case is consistent with the approach taken by the courts in overseas jurisdictions. In the case of *Re Coward; Coward v Larkman* (1887) 57 LT 285, Fry LJ of the English Court of Appeal stated that rules of interpretation (including the *contra proferentem* rule) *"****point out what a Court shall do in the absence of express or implied intention to the contrary****"*. Bowen LJ in that same case stated that rules of interpretation are mere presumptions which *"****disappear at once if a contrary intention appears****"* in the contract. The decisions of their Lordships have been applied by the High Court of Australia (in *Nicol v Chant* (1909) 7 CLR 569 at 591) and by the Court of Appeal of New Zealand (in Re Lowry's Trust; Logan v Lowry (1948) NZLR 738 at 755).

**Conclusion**

Parties who prepare contracts or who seek to rely on contractual provisions such as guarantees, indemnities, limitations or exclusions may wish to consider contracting out of the contra proferentem rule. Case authority in Australia, New Zealand and England suggests that such contracting out is possible. Conversely, parties who have not had a large part in preparing a contract, or who grant an indemnity or guarantee under the contract, may wish to resist any such contracting out.

**Beware of the condition precedent clause**, Alway Associates, <http://www.alway-associates.co.uk/legal-update/article.asp?id=259>

***Condition precedent – JCT Trade Contract - loss and expense – notice provisions***

How damaging can the failure to submit a timely application for recovery of loss and expense be and can it ultimately prevent entitlement? Well, in a very recent judgment in the case of ***WW Gear Construction Limited v McGee Group Limited [2010] EWHC 1460 TCC***, it was held that the contractors entitlement to pursue such losses under the Contract would be compromised when failing to comply with the timing and application of the notice provisions as set out in the amended JCT contract.

The Contract in this particular case comprised the JCT Trade Contract (TC/C) 2002 edition with Amendments 1:2003 and further bespoke amendments.

The Trade Contractor (McGee) was employed to undertake ground works including excavation. Payment disputes arose related to delay and disruption for which McGee made application for extended preliminary costs within its regular applications for payment. In fact, within a later application for payment, McGee made specific reference to “Loss and Expense Claim” being “As attached” and included various other heads of claim.

The Employer (Gear) had previously sought via Adjudication amongst other things proper interpretation and implementation of the contract clauses related to extension of time and loss and expense and in particular the matter of the condition precedent. Dissatisfied with the Adjudicator’s Decision, who had confirmed that the condition precedent requiring McGee to make an application in the manner and within the timescales set out within the Contract was “devoid of meaning” and of no effect, Gear instigated legal proceedings seeking a declaration in its favour.

The specific provision of the Trade Contract in question and examined was Clause 4.21 which read as follows: -

*“If the Trade Contractor makes written application to the Construction Manager stating that he has incurred or is likely to incur direct loss and/or expense (of which the Trade Contractor may give his quantification) in the execution of this Trade Contract… because the regular progress of the Works or any part thereof has been or is likely to be materially affected by any one or more of the matters referred to in clause 4.22; and if as soon as the Construction Manager is of the opinion…that the regular progress of the Works or of any part thereof has been or is likely to be so materially affected as set out in the application of the Trade Contractor then the Construction Manager from time to time thereafter shall ascertain the amount of such loss and/or expense which has been or is being incurred by the Trade Contractor; provided always that:*

*.1 the Trade Contractor’s application shall be made as soon as and in any event not later than two months after it has become, or should reasonably have become, apparent to him that the regular progress of the Works or any part thereof has been or was likely to be affected as aforesaid, and such application shall be formally made in writing and fully documented and costed in detail, and it shall be a condition precedent to the Trade Contractor’s entitlement under this clause 4.21.1 or clause 4.25 that the Trade Contractor has complied fully with all the requirements of this clauses [sic] including, for the accordance [sic] of doubt, the said time period of two months.*

The judgment handed down clarified firstly that the trigger under sub clause 4.21 (being one of those “if” clauses referred to in the case of ***London Borough of Merton v Stanley Hugh Leach***)was the making of the application by the Contractor. As such there was no obligation for the Construction Manager or the Employer to ascertain loss and expense without such application from McGee. Also, that the words *“****provided always that****”* **at the end of this sub clause above is usually a clear and strong sign that the Parties intended there to be a condition precedent**.

Turning to the sub-sub clause 4.21.1 above, Justice Akenhead held that there was nothing particularly difficult or onerous requiring the Contractor to make its application within the general or specific timescales. Finally, that the requirement to make a timely and written application as set out above is a pre-condition to the recovery of loss and/or expense.

**Conclusion**

The key message from this case is to make sure that you are aware of any provisions that fall under the category of being condition precedent and the consequences of failing to comply (preferably before signing the contract) as a properly constructed clause of this nature will be enforceable. The Contract in this case was an amended JCT contract and it is not unusual to find standard contracts being amended to incorporate clauses of this nature; not just related to payment and extension of time but other matters too including suspension of the works.

It is also worth stating that despite any entitlement under the contract being lost due to the failure to comply with the contractual provisions the right to recover at common law may still be available in the absence of any clear words to the contrary.

**Time bars in construction and global claims, Simon Tolson & Jeremy Glover,** <http://www.fenwickelliott.com/files/Time%20bars%20in%20constructions%20contracts%20and%20global%20claims.pdf>

* Time bars in construction contracts

Clause 61.3 of NEC3 says this:

The Contractor notifies the Project Manager of an event which has happened or which he expects to happen as a compensation event if  The Contractor believes that the event is a compensation event and  The Project Manager has not notified the event to the Contractor.  If the Contractor does not notify of a compensation event within eight weeks of becoming aware of the event, he is not entitled to a change in the Prices, the Completion Date or a Key Date unless the Project Manager should have notified the event to the Contractor but did not.

Sub-clause 20.11 of the FIDIC form states that:

If the Contractor considers himself to be entitled to any extension to the Time for Completion and/or any additional payment, under any Clause of these Conditions or otherwise in connection with the Contract, the Contractor shall give notice to the Engineer, describing the event or circumstance giving rise to the claim. The notice shall be given as soon as practicable, and not later than 28 days after the Contractor became aware, or should have become aware, of the event or circumstance.  If the Contractor fails to give notice of a claim within such period of 28 days, the Time for Completion shall not be extended, the Contractor shall not be entitled to additional payment, and the Employer shall be discharged from all liability in connection with the claim. Otherwise, the following provisions of this Sub-Clause shall apply.

The regime is different between FIDIC and NEC. Under FIDIC, the duty is to notify of an entitlement to additional time or money; under NEC3 there is a duty to notify of an event.

This is a fundamental requirement of the NEC3. The Contractor must give notice of compensation events within eight weeks of becoming aware. At its most straightforward under NEC3 the prevention principle does not operate to prevent the Employer’s right to have the Contractor pay delay damages under NEC3 Clause X7.1 simply because the Contractor has not exercised his right to give notice in accordance with clause 61.3 for the Employer’s breach of contract.

Sub-clause 61.3 is a condition precedent and potentially provides the employer with a complete defence to any claim for time or money by the contractor not started within the required time frame.

Generally, in England and Wales, the courts will take the view that timescales in construction contracts are directory rather than mandatory, so that the contractor should not lose its right to bring its claim if such claim is not brought within the stipulated timescale

* Are there any ways round the condition precedent?

The point made by the Judge is that whilst clause 13.8 provides immunity, that immunity must be invoked or referred to. At a meeting between contractor and employer, the EOT claim was discussed at length. Given the importance of clause 13.8, in the view of the Judge, it would be surprising if no mention was made of the clause unless the employer, or architect, had decided not to invoke it. Significantly, the Judge held that both employer and architect should be aware of all of the terms of the contract. Therefore, it is important that all certifiers are aware of the potential consequences if, by their actions, they could be deemed to have waived time bar clauses or other condition precedents.

Employers and certifiers alike will need to pay close attention to their conduct in administering contracts in order to avoid the potential consequences of this decision.

**Ccl 1:** In summary, it seems clear that under English law a condition precedent will be held to be effective, so as to preclude a claimant from bringing an otherwise valid claim, provided that the wording of the contract is clear that that is its intention. However, might it be that Mr Justice Jackson’s comments amount to a high-water mark in the enforcement of condition precedents? The FIDIC approach seems to be changing. In autumn 2007, FIDIC introduced a new draft form of contract, the D-B-O form. This included the following concession within clause 20:  20.1(a) However, if the Contractor considers there are circumstances which justify the late submission, he may submit the details to the DAB for a ruling. If the DAB considers the circumstances are such that the late submission was acceptable, the DAB shall have the authority under this sub-clause to override the given 28-day limit and advise both the parties accordingly.

Further, as can be seen from the *City Inn* case, in practice, the particular circumstances of each situation will need to be considered, not solely because the courts construe these provisions extremely strictly, but also because the actual circumstances of the case might reveal that the time bar provision cannot be considered to be effective.8 And here, HHJ Davies’ comments in the *Steria* case may prove to be of value. Certainly this particular area is likely to become an increasingly fertile ground for dispute.

* Global claims and concurrent delay

**Ccl 2**: This leaves open the question of whether a global claim will succeed at trial. At trial, it should not be forgotten that you must prove your case and there is an important distinction between a global claim as a matter of pleading and a global claim as a matter of evidence. The position seems to be this:

(i)  Where a claim for an extension of time and/or loss and expense is advanced pursuant to contractual terms, then an arbitrator or the court can make a global award, subject to the same limitations as were set out in *Crosby* and *Merton*. But the mood is against merely impressionistic assessments, and a claimant is far more likely to succeed if he can show what effects flowed from what events giving rise to entitlement; and

(ii)  Where the claim is for damages for breach of contract, the claimant’s task may be somewhat easier, because he will usually be able to claim damages for loss of a chance, at any rate in the alternative, and under that head the arbitrator or the court is much more likely to be persuaded indeed is probably required to take an impressionistic approach.

Cours 7

**Clauses of the FIDIC Silver Book**

* **4.24 Fossils**

All fossils, coins, articles of value or antiquity, and structures and other remains or items of geological or archaeological interest found on the Site **shall be placed under the care and authority of the Employer**. The Contractor shall take reasonable precautions to prevent Contractor’s Personnel or other persons from removing or damaging any of these findings.

The Contractor shall, upon discovery of any such finding, **promptly give notice to the Employer**, who shall issue instructions for dealing with it. If the Contractor suffers delay and/or incurs Cost from complying with the instructions, the Contractor shall give a further notice to the Employer and shall be entitled subject to Sub-Clause 20.1 *[Contractor*’*s Claims]* to:

(a)  an extension of time for any such delay, if completion is or will be delayed, under Sub-Clause 8.4 *[Extension of Time for Completion]*, and

(b)  payment of any such Cost, which shall be added to the Contract Price.

After receiving this further notice, the Employer shall proceed in accordance with Sub-Clause 3.5 *[Determinations]* to agree or determine these matters.

* **13 Variations and Adjustments**

**13.1  Right to Vary**

**Variations may be initiated by the Employer at any time prior to issuing the Taking-Over Certificate for the Works, either by an instruction or by a request for the Contractor to submit a proposal**. A Variation shall not comprise the omission of any work which is to be carried out by others.

**The Contractor shall execute and be bound by each Variation, unless the Contractor promptly gives notice to the Employer stating** (with supporting particulars) that (i) the Contractor cannot readily obtain the Goods required for the Variation, (ii) it will reduce the safety or suitability of the Works, or (iii) it will have an adverse impact on the achievement of the Performance Guarantees. Upon receiving this notice, the Employer shall cancel, confirm or vary the instruction.

**13.2  Value Engineering**

The Contractor may, at any time, submit to the Employer a written proposal which (in the Contractor’s opinion) will, if adopted, (1) accelerate completion, (ii) reduce the cost to the Employer of executing, maintaining or operating the Works, (iii) improve the efficiency or value to the Employer of the completed Works, or (iv) otherwise be of benefit to the Employer .

The proposal shall be prepared at the cost of the Contractor and shall include the items listed in Sub-Clause 13.3 *[Variation Procedure]*.

**13.3  Variation Procedure**

If the Employer requests a proposal, prior to instructing a Variation, the Contractor shall respond in writing as soon as practicable, either by giving reasons why he cannot comply (if this is the case) or by submitting:

(a)  a description of the proposed design and/or work to be performed and a programme for its execution,

(b)  the Contractor’s proposal for any necessary modifications to the programme according to Sub-Clause 8.3 *[Programme]* and to the Time for Completion, and

(c)  the Contractor’s proposal for adjustment to the Contract Price.

The Employer shall, as soon as practicable after receiving such proposal (under Sub- Clause 13.2 *[Value Engineering]* or otherwise), respond with approval, disapproval or comments. The Contractor shall not delay any work whilst awaiting a response.

Each instruction to execute a Variation, with any requirements for the recording of Costs, shall be issued by the Employer to the Contractor, who shall acknowledge receipt.

Upon instructing or approving a Variation, the Employer shall proceed in accordance with Sub-Clause 3.5 *[Determinations]* to agree or determine adjustments to the Contract Price and the Schedule of Payments. These adjustments shall include reasonable profit, and shall take account of the Contractor’s submissions under Sub Clause 13.2 *[Value Engineering]* if applicable.

**13.4  Payment in Applicable Currencies**

If the Contract provides for payment of the Contract Price in more than one currency, then whenever an adjustment is agreed, approved or determined as stated above, the amount payable in each of the applicable currencies shall be specified. For this purpose, reference shall be made to the actual or expected currency proportions of the Cost of the varied work, and to the proportions of various currencies specified for payment of the Contract Price.

**13.5  Provisional Sums**

Each Provisional Sum shall only be used, in whole or in part, in accordance with the Employer’s instructions, and the Contract Price shall be adjusted accordingly. The total sum paid to the Contractor shall include only such amounts, for the work, supplies or services to which the Provisional Sum relates, as the Employer shall have instructed. For each Provisional Sum, the Employer may instruct:

(a)  work to be executed (including Plant, Materials or services to be supplied) by the Contractor and valued under Sub-Clause 13.3 *[Variation Procedure]*; and/or

(b)  Plant, Materials or services to be purchased by the Contractor, for which there shall be added to the Contract Price less the original Provisional Sums:

* 1. (i)  the actual amounts paid (or due to be paid) by the Contractor, and
  2. (ii)  a sum for overhead charges and profit, calculated as a percentage of these actual amounts by applying the relevant percentage rate (if any) stated in the Contract.

The Contractor shall, when required by the Employer, produce quotations, invoices, vouchers and accounts or receipts in substantiation.

**13.6 Daywork**

For work of a minor or incidental nature, the Employer may instruct that a Variation shall be executed on a daywork basis. The work shall then be valued in accordance with the daywork schedule included in the Contract, and the following procedure shall apply. If a daywork schedule is not included in the Contract, this Sub-Clause shall not apply.

Before ordering Goods for the work, the Contractor shall submit quotations to the Employer. When applying for payment, the Contractor shall submit invoices, vouchers and accounts or receipts for any Goods.

Except for any items for which the daywork schedule specifies that payment is not due, the Contractor shall deliver each day to the Employer accurate statements in duplicate which shall include the following details of the resources used in executing the previous day’s work:

(a)  the names, occupations and time of Contractor’s Personnel,

(b)  the identification, type and time of Contractor’s Equipment and  Temporary Works, and

(c)  the quantities and types of Plant and Materials used.

One copy of each statement will, if correct, or when agreed, be signed by the Employer and returned to the Contractor. The Contractor shall then submit priced statements of these resources to the Employer, prior to their inclusion in the next Statement under Sub- Clause 14.3 *[Application for Interim Payments]*.

**13.7  Adjustments for Changes in Legislation**

The Contract Price shall be adjusted to take account of any increase or decrease in Cost resulting from a change in the Laws of the Country (including the introduction of new Laws and the repeal or modification of existing Laws) or in the judicial or official governmental interpretation of such Laws, made after the Base Date, which affect the Contractor in the performance of obligations under the Contract.

If the Contractor suffers (or will suffer) delay and/or incurs (or will incur) additional Cost as a result of these changes in the Laws or in such interpretations, made after the Base Date, the Contractor shall give notice to the Employer and shall be entitled subject to Sub- Clause 20.1 *[Contractor*’*s Claims]* to:

(a)  an extension of time for any such delay, if completion is or will be delayed, under Sub-Clause 8.4 *[Extension of Time for Completion]*, and

(b)  payment of any such Cost, which shall be added to the Contract Price.

After receiving this notice, the Employer shall proceed in accordance with Sub-Clause 3.5

*[Determinations]* to agree or determine these matters.

**13.8  Adjustments for Changes in Costs**

If the Contract Price is to be adjusted for rises or falls in the cost of labour, Goods and other inputs to the Works, the adjustments shall be calculated in accordance with the provisions in the Particular Conditions.

* **17.2  Contractor’s Care of the Works**

**The Contractor shall take full responsibility for the care of the Works and Goods from the Commencement Date until the Taking-Over Certificate is issued** (or is deemed to be issued under Sub-Clause 10.1 *[Taking Over of the Works and Sections]*) **for the Works, when responsibility for the care of the Works shall pass to the Employer**. If a Taking-Over Certificate is issued (or is so deemed to be issued) for any Section of the Works, responsibility for the care of the Section shall then pass to the Employer.

After responsibility has accordingly passed to the Employer, the Contractor shall take responsibility for the care of any work which is outstanding on the date stated in a Taking-Over Certificate, until this outstanding work has been completed.

If any loss or damage happens to the Works, Goods or Contractor’s Documents during the period when the Contractor is responsible for their care, from any cause not listed in Sub-Clause 17.3 *[Employer*’*s Risks],* the Contractor shall rectify the loss or damage at the Contractor’s risk and cost, so that the Works, Goods and Contractor’s Documents conform with the Contract.

The Contractor shall be liable for any loss or damage caused by any actions performed by the Contractor after a Taking-Over Certificate has been issued. The Contractor shall also be liable for any loss or damage which occurs after a Taking-Over Certificate has been issued and which arose from a previous event for which the Contractor was liable.

* **17.3  Employer’s Risks**

The risks referred to in Sub-Clause 17.4 below are:

(a)  war, hostilities (whether war be declared or not), invasion, act of foreign enemies,

(b)  rebellion, terrorism, revolution, insurrection, military or usurped power, or civil war, within the Country,

(c)  riot, commotion or disorder within the Country by persons other than the Contractor’s Personnel and other employees of the Contractor and Subcontractors,

(d)  munitions of war, explosive materials, ionising radiation or contamination by radio-activity, within the Country, except as may be attributable to the Contractor’s use of such munitions, explosives, radiation or radio-activity, and.

(e)  pressure waves caused by aircraft or other aerial devices travelling at sonic or supersonic speeds.

* **17.4 Consequences of Employer’s Risks**

If and to the extent that any of the risks listed in Sub-Clause 17.3 above results in loss or damage to the Works, Goods or Contractor’s Documents, the Contractor shall promptly give notice to the Employer and shall rectify this loss or damage to the extent required by the Employer.

If the Contractor suffers delay and/or incurs Cost from rectifying this loss or damage, the Contractor shall give a further notice to the Employer and shall be entitled subject to Sub-Clause 20.1 *[Contractor*’*s Claims]* to:

(a)  an extension of time for any such delay, if completion is or will be delayed, under Sub-Clause 8.4 *[Extension* of *Time* for *Completion],* and

(b)  payment of any such Cost, which shall be added to the Contract Price.

After receiving this further notice, the Employer shall proceed in accordance with Sub Clause 3.5 *[Determinations]* to agree or determine these matters.

* **19 Force Majeure**

**19.1  Definition of Force Majeure**

In this Clause, “Force Majeure” means **an exceptional event or circumstance:**

(a)  which is beyond a Party’s control,

(b)  which such Party could not reasonably have provided against before  entering into the Contract,

(c)  which, having arisen, such Party could not reasonably have avoided or  overcome, and

(d)  which is not substantially attributable to the other Party.

Force Majeure may include, but is not limited to, exceptional events or circumstances of the kind listed below, so long as conditions (a) to (d) above are satisfied:

(i)  war, hostilities (whether war be declared or not), invasion, act of foreign enemies,

(ii)  rebellion, terrorism, revolution, insurrection, military or usurped power, or civil war,

(iii)  riot, commotion, disorder, strike or lockout by persons other than the Contractor’s Personnel and other employees of the Contractor and Sub-contractors,

(iv)  munitions of war, explosive materials, ionising radiation or contamination by radio-activity, except as may be attributable to the Contractor’s use of such munitions, explosives, radiation or radio- activity, and

(v)  natural catastrophes such as earthquake, hurricane, typhoon or volcanic activity.

**19.2  Notice of Force Majeure**

If a Party is or will be prevented from performing any of its obligations under the Contract by Force Majeure, then it shall give notice to the other Party of the event or circumstances constituting the Force Majeure and shall specify the obligations, the performance of which is or will be prevented. The notice shall be given within 14 days after the Party became aware, or should have become aware, of the relevant event or circumstance constituting Force Majeure.

The Party shall, having given notice, be excused performance of such obligations for so long as such Force Majeure prevents it from performing them.

Notwithstanding any other provision of this Clause, Force Majeure shall not apply to obligations of either Party to make payments to the other Party under the Contract.

**19.3  Duty to Minimise Delay**

Each Party shall at all times use all reasonable endeavors to minimize any delay in the performance of the Contract as a result of Force Majeure.

A Party shall give notice to the other Party when it ceases to be affected by the Force Majeure.

**19.4  Consequences of Force Majeure**

If the Contractor is prevented from performing any of his obligations under the Contract by Force Majeure of which notice has been given under Sub-Clause 19.2 *[Notice of Force Majeure]*, and suffers delay and/or incurs Cost by reason of such Force Majeure, the Contractor shall be entitled subject to Sub-Clause 20.1 *[Contractor*’*s Claims]* to:

(a)  an extension of time for any such delay, if completion is or will be delayed, under Sub-Clause 8.4 *[Extension of Time for Completion]*, and

(b)  if the event or circumstance is of the kind described in sub-paragraphs (i) to (iv) of Sub-Clause 19.1 *[Definition of Force Majeure]* and, in the case of sub-paragraphs (ii) to (iv), occurs in the Country, payment of any such Cost.

After receiving this notice, the Employer shall proceed in accordance with Sub-Clause 3.5 *[Determinations]* to agree or determine these matters.

**19.5  Force Majeure Affecting Subcontractor**

If any Subcontractor is entitled under any contract or agreement relating to the Works to relief from force majeure on terms additional to or broader than those specified in this Clause, such additional or broader force majeure events or circumstances **shall not excuse the Contractor’s non-performance or entitle him to relief under this Clause**.

**19.6  Optional Termination, Payment and Release**

If the execution of substantially all the Works in progress is prevented for a continuous period of 84 days by reason of Force Majeure of which notice has been given under Sub-Clause 19.2 *[Notice of Force Majeure]*, or for multiple periods which total more than 140 days due to the same notified Force Majeure, **then either Party may give to the other Party a notice of termination of the Contract**. In this event, the termination shall take effect 7 days after the notice is given, and the Contractor shall proceed in accordance with Sub-Clause 16.3 *[Cessation of Work and Removal of Contractor*’*s Equipment]*.

Upon such termination, the Employer shall pay to the Contractor:

(a)  the amounts payable for any work carried out for which a price is stated in the Contract;

(b)  the Cost of Plant and Materials ordered for the Works which have been delivered to the Contractor, or of which the Contractor is liable to accept delivery: this Plant and Materials shall become the property of (and be at the risk of) the Employer when paid for by the Employer, and the Contractor shall place the same at the Employer’s disposal;

(c)  any other Cost or liability which in the circumstances was reasonably incurred by the Contractor in the expectation of completing the Works;

(d)  the Cost of removal of Temporary Works and Contractor’s Equipment from the Site and the return of these items to the Contractor’s works in his country (or to any other destination at no greater cost); and

(e)  the Cost of repatriation of the Contractor’s staff and labour employed wholly in connection with the Works at the date of termination.

**19.7  Release from Performance under the Law**

Notwithstanding any other provision of this Clause, if any event or circumstance outside the control of the Parties (including, but not limited to, Force Majeure) arises which makes it impossible or unlawful for either or both Parties to fulfil its or their contractual obligations or which, under the law governing the Contract, entitles the Parties to be released from further performance of the Contract, then upon notice by either Party to the other Party of such event or circumstance:

(a)  the Parties shall be discharged from further performance, without prejudice to the rights of either Party in respect of any previous breach of the Contract, and

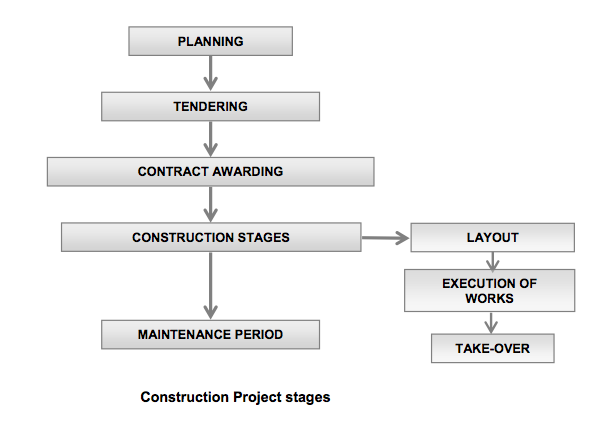
(b)  the sum payable by the Employer to the Contractor shall be the same as would have been payable under Sub-Clause 19.6 *[Optional Termination, Payment and Release]* if the Contract had been terminated under Sub-Clause 19.6.

Cours 8

1. **Manual on construction risks, damage to the works and advanced loss of profits**

<http://www.mapfre.com/ccm/content/documentos/mapfrere/fichero/en/Manual-Construction-Risks-ALOP.pdf>

The execution of any civil works or construction project (or the improvement of already existing ones) begins long before the machinery starts to operate at the worksite. Prior to this, it is developed a laborious process which starts when a necessity to be met is considered to exist, either to improve the public services or to satisfy private needs (e.g., the need for a road is put forward for the improvement of communications between two towns, etc.). Then, it shall be necessary to study the different possible alternatives, the economic cost and the social and environmental impacts of the construction work. Eventually, the most adequate alternative shall be adopted. This process can take months and even years, so that the promoter can be either private or the Public Administration.



**Project construction stages**:

Planning :

* feasibility study
* drafts
* construction projects

Tendering:

* documents and administrative clauses

Contract awarding:

* evaluation of the bids

Construction

Take over and maintenance period

**The Civil Works Contract**:

Contents of the project document

* project report
* general and detailed layout plans
* a set of particular technical prescriptions
* project budget
* work plan
* references
* documentation/regulations
* the Health and safety study

Geotechnical study

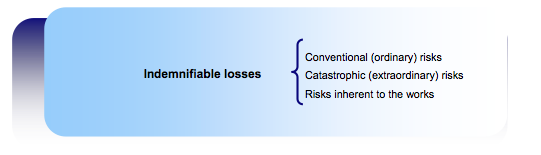
Health and safety projects : high importance

Environmental impact study

Provisions on quality control at the construction site

**Construction risks**:

It would be impossible to enumerate all the risks which may arise during the development of construction projects, as the likelihood and unforeseeability of accidents are sufficient factors to have them covered. Therefore, we shall focus on those usually subject to insurance coverage. These are divided into three different categories:



Catastrophic risks:

The most remarkable are those derived from **Acts of God** (which are foreseeable, although their

effects are unavoidable), as well as other risks which are absolutely **unforeseeable**. Among the catastrophic risks, the ones caused by **Acts of God** comprise the following:

Winds, storms, hurricanes and cyclones: They may cause serious damage, and hence this fact must be taken into account in the project at the time of making the calculations in compliance with the regulations regarding this matter; although the completed projects are protected, this hazard exists during the construction stage.

In the case of Spain, rarely do these events bring about total losses. However, the number of partial accidents due to said circumstances is remarkable, the most frequent being those related to crane overturns, aluminium roofs being dislodged, collapse of fresh walls, etc.

Floods and water-induced damage: Atmospheric variations imply that hydrological phenomena are likely to happen. Along with the fact that the mere existence of water at the worksite is already a permanent risk for the construction, it can be concluded that damage by water is one of the most frequent ones in insurance claims.

On the other hand, with regard to **unforeseeable accidents,** delimiting the fortuitous case is a much more complex question which is usually left to the judgement of the court, so that it is a matter of case law.

* The event must happen absolutely by chance. Although it is possible, it is not an avoidable consequence of the activity developed.
* There must be total absence of fraudulent behaviour.
* A sufficient activity must have been made in order to prevent the damage.

The fortuitous case excludes the insured’s liability, in the absence of express legal provision, so that it usually brings as a consequence an obligation for the insurance provider to compensate for the damage to the insured and, if any, to third parties.

1. **Force Majeure clauses: FIDIC, ENAA and drafting bespoke Clauses, Herbert Smith**

<http://www.herbertsmithfreehills.com/-/media/HS/T-300312-6.pdf>

The term "Force Majeure" originates from the **French Code Napoleon** (now the Code Civil) which states **"*There is no place for any damages when, as a result of Force Majeure the debtor has been prevented from... doing that to which he was obliged*."**

However, "Force Majeure" has not been recognised as having a precise meaning in English law.

Without a clear definition and provisions that effectively set out the parties' rights and remedies, contracting parties will be at the mercy of the rigid English doctrine of frustration of contracts and the inflexibility of the Law Reform (Frustrated Contracts) Act 1943.

Properly drafted force majeure clauses should provide a sophisticated mechanism for dealing with the consequences of events and prescribe a range of remedies available to the parties as a result. However the drafting of force majeure clauses is by no means consistent throughout standard and bespoke forms.

**FIDIC**

In **Clause 19 of the FIDIC** 1999 Red, Yellow and Silver Books, the term "Force Majeure" is principally identified as being an "exceptional" event or circumstance, beyond the Party's control, and something that it could not have reasonably provided against before entering into the Contract.

Further, the event cannot be one that the Party could have reasonably avoided or overcome, nor is it allowed to be "substantially" attributable to the other Party.

Thereafter follows a non-exhaustive list of categories of events that could fall within the definition Force Majeure, with again the qualification that the event has to be "exceptional" and the other conditions referred to above have to be satisfied. As will be seen below, as the available relief depends on the type of event, it is worth noting each of the categories here:

* category (i) includes war and other hostilities;
* category (ii) includes rebellion, terrorism and civil war;
* category (iii) includes riots and strikes, but only strikes by persons other than the Contractor's personnel and Subcontractors;
* category (iv) includes explosive materials and radioactive contamination, so long as not attributable to the Contractor's use of such materials;
* and category (v) includes natural catastrophes such as earthquakes, hurricanes, typhoons and volcanic activity.

Relief is only available where the Contractor is "prevented" from performing any of its obligations by reason of an event that satisfies all of the above conditions for Force Majeure. To invoke the relief, the prevention must be physical or legal prevention and not simply economic unprofitability (i.e. a party will not be able to claim that it was "prevented" from performing the contract just because the cost of performance increases above what was originally anticipated) .

In Fairclough Dodd & Jones Ltd v J.H. Vantol Ltd, the court held that the word "prevented" meant that relief was only available where shipment remained impossible up to the end of the contract period.

**The Contractor will be entitled to an extension of time for delays arising from being "prevented" from performing the Contract in respect of all categories of Force Majeure events.**

However, it will only be able to recover cost (never profit) in relation to some types of Force Majeure: for all category (i) events, and for category (ii), (iii) and (iv) events if they occur in the country where the site is located; **the Contractor will not be entitled to recover costs arising in relation to natural catastrophes (category (v)).**

* The Clause is silent as to what financial remedy the Contractor would be entitled to in the event of an exceptional event which satisfies the criteria in the first paragraph of Clause 19.1, but does not fall within any of the listed categories.

As well as being able to recover its costs, the Contractor will also be entitled under the Employer's Risks provisions in Clause 17 to an extension of time and cost (again, not profit) in relation to any remedial work required by the Employer due to loss or damage caused to the Works, Goods or Contractor's Documents arising as a result of a Force Majeure event; although in relation to category (iii) only if the event occurred within the country in which the site is located.

Either party may give notice terminating the Contract in the event of prolonged Force Majeure (more than 84 days for one event, or more than 140 days in total) that "substantially" prevents the execution of all of the Works. The Contractor is then entitled to recover certain costs (as listed in Clause 19.6) while any part of the advance payment that has not been repaid by the Contractor becomes immediately payable to the Employer (Clause 14.2).

Notwithstanding the relief available for Force Majeure, by Clause 19.7 the parties are also entitled to be discharged from further performance of the Contract if an event occurs outside their control (including but not restricted to Force Majeure) which either makes it "impossible or unlawful" for them to fulfil their contractual obligations, or which entitles them to be released from performance under the governing law of the Contract; **i.e. under common law frustration if English law applies**.

In respect of the former, given that under English law "prevention" suggests impossibility and also covers unlawful prevention, there would seem to be an argument that both Clauses might apply to the same event. However, it would appear that the words "impossible or unlawful" in Clause 19.7 suggest a higher threshold for release from performance than the "prevention" requirement for Force Majeure relief.

**ENAA**

* ENAA takes a slightly different approach to FIDIC in that, at General Condition ("GC") 37, Force Majeure is primarily defined as an event beyond the reasonable control of the affected party, which is unavoidable.
* Thereafter follows a non-exhaustive list of categories of events that would be considered to be Force Majeure. The list is similar to that at Clause 19 of the FIDIC forms, but with an additional category covering labour, materials and utilities shortages that are themselves caused by Force Majeure events.

Unlike FIDIC where relief is only available if performance has been "prevented", **ENAA's Force Majeure relief applies if a party has been "prevented, hindered or delayed" by reason of Force Majeure**.

To "hinder" means to render performance more difficult, but not impossible. As a result, the ENAA wording provides relief not only for total non-performance **but also varied performance**.

Another notable difference between FIDIC and ENAA is that, while compliance with the ENAA notice provisions is also mandatory, the time for giving notice runs from the occurrence of the event, rather than from awareness of the event under FIDIC. Further, under ENAA the Force Majeure relief is expressed as not applying to the Owner's payment obligations, whereas under FIDIC Force Majeure relief will not apply to either party's payment obligations.

* The party affected by a Force Majeure under ENAA will be relieved from performance and entitled to an extension of time for any consequential delay.
* With regard to recovery of cost, the starting point in ENAA is that neither party will be liable in damages or for additional cost by reason of the delay or non-performance.
  + However, there are exceptions.
    - First, by GC 32.2, if the Works are lost or damaged by reason of "occurrences that an experienced contractor could not reasonably foresee or if reasonably foreseeable could not reasonably make provision for or insure against " (which, it would seem, could include Force Majeure as defined in GC 37) or by reason of nuclear reaction or radiation contamination or pressure waves caused by aircraft or other aerial objects, and in all cases if such events relate to the country where the site is located, **then the Owner is obliged to pay the Contractor for all Works executed even if they have been lost, damaged or destroyed**. Further, if the Owner instructs the Contractor to conduct repairs the Contractor will be entitled to claim the cost of doing so.
    - The second exception relates to War Risks, which are defined as any event specified in paragraphs (a) and (b) of the non-exhaustive list of Force Majeure events in GC 37.1, and any explosion or impact of any mine, bomb, missile etc, occurring in or near the country where the site is located. If the Works, Materials or Construction Equipment, or any other property of the Contractor to be used for the purposes of the Works, is damaged or destroyed by reason of a War Risk then the Contractor is entitled to relief similar to that provided in GC 32.2. Further, **the Owner** is obliged to pay the Contractor any increase in the cost of executing the Works that is in any way caused by or connected to the War Risk.

**Termination rights arise in the event that performance is "substantially" prevented, hindered or delayed by Force Majeure event(s) for an aggregate of 120 days or more**.

This is without prejudice to the parties' right to terminate in the event of prolonged War Risks which cause the execution of the Works to become "impossible or is substantially prevented" for more than 60 days.

Again, given English law authority on the interpretation of the term "prevent", **it is likely that there will be difficulties in differentiating between the terms "impossible" and "substantially prevented",** but overall the intention appears to be to create a higher threshold for terminating for War Risks than for other Force Majeure events.

In the event of termination the Contractor is entitled to recover certain defined costs.

**Drafting bespoke Force Majeure clauses**

When considering the elements that should make up the force majeure clause in a construction contract, the first point to note is that the use of the term "force majeure" without any qualification is generally to be avoided. Indeed, **it has been held that a clause referring to "the usual force majeure events" may be void for uncertainty. By contrast, it is possible to adopt a general definition of the effects of the force majeure event**. Then a non-exclusive list of qualifying events may be included which should be tailored to the particular needs of the contract and should where necessary match other contractual provisions in connected contracts. It may also be necessary to specify events which will not constitute force majeure to avoid any doubt.

Provision should be made as to the manner in which notice of the event is to be given and the criteria (e.g. awareness or occurrence of the event) which should trigger the need for notice. The clause should state the consequence of non-compliance with the notice provision and in particular whether it has mandatory or directory effect. It should define the effect which triggers the clause, for example whether hindrance as well as prevention will suffice.

**The clause should proceed to define the consequences of a force majeure event and who is to be responsible for assessing these in the first place, for example, project manager or architect/engineer.** The consequences should then be defined and guidelines given as to how they are to be assessed, for example, whether any extension of time should be reasonable in all the circumstances. The consequences to be specified should include the effect of delaying events leading to an extension of time, any provision to be made for costs to be recovered as a result of the delay, as well as impact on performance and the possibility of termination.

Where termination as a result of a force majeure event is to be provided for, the clause should state the criteria (e.g. length of days of delay) by which it should be found to be necessary. The clause should provide for notice of termination to be given and whether or not this can be done by either or both parties. The consequences of termination should then be spelt out either by reference to existing provision (for example, as for termination for convenience) or provision specific to the force majeure clause itself.

Provision for the consequences of termination should include issues such as payment for work done and for costs due to termination; it should also be clarified whether the latter should include profit.

Finally, the parties should decide whether or not to exclude the common law rights of frustration or whether to make express provision that they are to be retained as is in the case of, for example, FIDIC.

Conclusion

The term "force majeure" is widely recognized by lawyers and contracting parties but is in fact rarely fully understood. This is largely because there is no legal definition of the term under English law and the standard form contracts all deal with the concept in different ways. Indeed, for a provision that is so commonly included in construction contracts, it is surprising how differently it is treated in the standard forms; not only in relation to the meaning of the term but also the relief afforded to the parties.

The impact of standard form provisions must therefore be fully understood before they are agreed to without revision. Likewise, when drafting bespoke clauses the parties should take care to address the fundamental drafting points discussed in this article. In all cases, the parties must satisfy themselves that the definition of force majeure will address the specifics of the project at hand and that the relief granted will be satisfactory in the circumstances. A failure properly to account for such matters in the contract could result in an affected party being solely reliant on the limited relief that might be available under the common law doctrine of frustration.

1. **Force majeure clauses, DLA Piper**

* Always included in project agreements
* **What is Force majeure?**
* Civil law concept that has no real meaning under the common law.
* Used in contracts because the only similar common law concept “the doctrine of frustration” has limited application because for it to apply the performance of a contract the doctrine of frustration - has limited application, because for it to apply the performance of a contract must be radically different from what was intended by the parties.
* Given force majeure clauses are creatures of contract, their interpretation will be governed by the normal rules of contractual construction. Force majeure provisions will be construed strictly and in the event of any ambiguity the contra proferentem rule will apply. Contra proferentem literally means "against the party putting forward". In this context, it means that the clause will be interpreted against the interests of the party that drafted it. The parties may contract out of this rule.
* The rule of ejusdem generis, which literally means "of the same class", may also be relevant. In other words, when general wording follows a specific list of events, the general wording will be interpreted in light of the specific list of events. In this context it means that when a broad "catch-all" phrase, such as "anything beyond the reasonable control of the parties", follows a list of more specific force majeure events, the catch-all phrase will be limited to events analogous to the listed events.
* Importantly, parties cannot invoke a force majeure clause if they are relying on their own acts or omissions.
* **General Force Majeure provisions**
* Traditionally, force majeure clauses, in referring to circumstances beyond the control of the parties, were intended to deal with unforseen acts of God or of governments and regulatory authorities.
  + More recently, force majeure clauses have been drafted to cover a wider range of circumstances that might impact on the commercial interests of the parties to the contract.
* the term force majeure has been construed to cover acts of God; war and strikes, even where the strike is anticipated; embargoes, refusals to grant licences; and abnormal weather conditions
* The underlying test in relation to most force majeure provisions is whether a particular event was within the contemplation of the parties when they made the contract. The event must also have been outside the control of the contracting party. Despite the current trend to expressly provide for specific force majeure events, case law actually grants an extensive meaning to the term force majeure when it occurs in commercial contracts.
* There are generally three essential elements to force majeure:
  + It can occur with or without human intervention.
  + It cannot have reasonably been foreseen by the parties.
  + It was completely beyond the parties' control and they could not have prevented its consequences.
* **Circumstances beyond the control of the person concerned**
* The phrase has been judicially held to refer to occurrences where neither the person concerned, nor any person acting on their behalf to do the act or take the step, could prevent
* Recent practice has significantly expanded the scope of such clauses to cover a wider range of circumstances that might impact on the commercial interests of the parties to the contract.
  + For instance: it seems that causes beyond the control of the parties that were known at the date of contracting may excuse performance only where they were of a temporary nature and are not doomed to operate on the contract.
* **The way forward**
* If a project company decides it wants to include a force majeure provision in its project agreements, the best way to limit the application of that clause is by defining a closed list of events that constitute force majeure for that contract. In other words, it should not include the catch all "any event beyond the reasonable control of the parties including....".
* Given force majeure is a creation of contract, the courts are unlikely to expand on the definition given by the parties.
* Obviously, this restricted approach is most appropriate when the counterparty has time-critical obligations, eg: in an Engineering, Procurement and Construction contract. However, where it is the project company that has time- critical obligations, eg in an off take agreement, the project company should adopt a more encompassing definition, including the traditional catch-all phrase.

1. **Force majeure clauses: the basics, By Denise Nestel**

A force majeure event is an uncontrollable, unavoidable event that makes a party’s performance impossible. A force majeure clause excuses nonperformance when impossibility results from a cause stated in the contract.

In conversation, force majeure is often used synonymously with acts of God or forces of nature. However, on a construction project, a force majeure event is, quite simply, whatever the contract says that it is.

In construction contracts, a force majeure event often includes acts of God and forces of nature, but also “man-made” events such as strikes, civil unrest, terrorism, inability to obtain resources, actions of governing authorities, enactment of governmental regulations, etc. The common denominator is that these events are beyond the control of the party seeking excuse from its failure to perform. In rare occasions, a contract simply defines force majeure loosely to include “anything beyond the parties’ control.”

Often, if a contract defines force majeure events, unless language expands that list by stating “including without limitation,” then an event not specified in the clause may not excuse nonperformance.

Usually, contracts require that a force majeure event must be not only beyond control of the party seeking protection, but also be unforeseeable. Foreseeability is determined at the time of entering the contract, not at the time the event occurs.

The majority of jurisdictions hold that a force majeure event discharges the party’s performance even if there is no force majeure clause because the party did not assume the risk of performance under any and all circumstances. A minority of jurisdictions hold that, in the absence of a force majeure clause, the party prevented from performing will be held liable for nonperformance consistent with the terms of the contract addressing default or nonperformance.

***What relief can a contractor expect if a force majeure occurs?***

The party seeking protection under a force majeure clause has the burden of proving the force majeure event exists and that it is preventing performance. A force majeure event can prevent performance, in whole or in part, temporarily or permanently. Typically, the relief pertains to the whole project. A hurricane, for example, requires demobilization of the project. But, as some contracts recognize, a force majeure may stop just part of the work and provide an excuse for only the affected part. For example, the contract may provide that only those acts subject to the force majeure are excused, but construction may continue in other areas, or that other types of work, such as purchasing of materials, must continue. A force majeure clause provides an excuse only so long as the impact of the force majeure prevents performance. Occasionally, a force majeure clause allows the affected party to terminate the contract if the force majeure is of a specified duration

***Does a force majeure clause provide compensation?***

Rarely is there any direct compensation. Most force majeure clauses only provide relief in the form of an extension of time without penalty or without assessment of liquidated damages for a period equal to the force majeure. Clauses seldom provide any compensation for the costs to demobilize and remobilize; to repair work; for the esca- lation of material and labor prices; or the premium demanded by transporters still operating in the affected areas. However, the contractor should review the changes or claims clause to see if it may still be able to recoup costs.

***A force majeure is not the same as commercial impracticability.***

Most construction contract force majeure clauses do not provide relief merely because the bargain has become more bur- densome or prices have escalated, making the contract commercially impracticable. For example, material price spikes due to regional or national material shortages are generally not considered force majeures.

***Force majeure clauses can often be negotiated.***

Since force majeure events are, by definition, not expected to occur, upstream par- ties may agree to extend the protections of a force majeure clause in terms of what qualifies as a force majeure, and what relief is available.

1. **Force majeure in troubled times: the example of Libya, Jones Day**

Uncertainty continues to prevail over Libya’s oil and gas industry, with each side in the developing civil war claiming to be in control of the country’s oil fields, pipelines, and ports.1

The upheaval in Libya—along with those elsewhere in the Middle East and North Africa—raises issues of force majeure that must be addressed promptly, in accordance with rights and obligations stipulated by contracts and applicable laws. These events also offer reminders and lessons to be taken into account when negotiating international contracts in these areas and elsewhere in the world.

***CONTRACTUAL FORCE MAJEURE PROVISIONS***

Force majeure is a legal concept that derives from Roman law (vis maior cui resisti non potest) and is present in many civil law systems. Under French law, for example, a party may be excused from performance of a contractual obligation by an unforeseeable and irresistible external event that makes performance of that obligation impossible.

Common law doctrines of frustration of contract and impracticability are analogous (but not identical) to force majeure.

The principle of force majeure is included in the UNIDROIT Principles of International Commercial Contracts, Article 7.1.7(1) of which provides:

* Nonperformance by a party is excused if that party proves that the nonperformance was due to an impediment beyond its control and that it could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences.

Article 360 of the Libyan Civil Code states the principle of force majeure as follows:

* An obligation is extinguished if the debtor establishes that his performance has become impossible by reason of causes beyond his control.

Libyan jurisprudence has interpreted this principle strictly: To qualify as force majeure, an event must be beyond the control of the parties, it must have been unforeseeable at the time the agreement was entered into, and it must render the performance of the obligation absolutely impossible

Alternatively, parties may conclude a contract that is based upon a model form that includes a force majeure clause. In the construction sector, certain widely used forms of contract published by the Fédération Internationale des Ingénieurs-Conseils (FIDIC) define “Force Majeure” as “an exceptional event or circumstance:

(a) which is beyond a Party’s control,

(b) which such Party could not reasonably have provided against before entering into the Contract,

(c) which, having arisen, such Party could not reasonably have avoided or overcome, and

(d) which is not substantially attributable to the other Party.”

Such “Force Majeure” may include (but is not limited to) “*rebellion, terrorism, revolution, military or usurped power or civil war,”* as well as “*riot, commotion, disorder, strike or lock- out by persons other than the Contractor’s personnel and other employees of the Contractor and Sub-contractors.”*

In contrast with Libyan law, the FIDIC forms (in common with many other contractual force majeure clauses) expressly exclude payment obligations from the benefit of their “Force Majeure” provisions.

***NOTICE OF FORCE MAJEURE***

In the event that force majeure has prevented (or will pre- vent) a party from performing an obligation, the relevant contract generally requires that party to give notice of the event and its effect to its counterparty. The contract may simply require notice within a “reasonable” time, or it may stipulate a specific deadline for the notice.

The FIDIC forms state that “***notice shall be given within 14 days after the Party became aware, or should have become aware, of the relevant event or circumstance constituting Force Majeure***.”

A party’s failure to give notice in accordance with relevant contractual requirements may bar that party from relying upon the force majeure (at least prior to an eventual compliant notice) and/or may allow the counterparty to claim damages arising from the late or absent notice.

Bearing in mind that a party claiming the benefit of force majeure to excuse nonperformance of a contractual obligation bears the burden of proving force majeure, it would be important to document all efforts—both successful and unsuccessful—to give notice.

***CONSEQUENCES OF FORCE MAJEURE***

The consequences of force majeure depend upon the relevant circumstances and the applicable contractual pro- visions. Often, force majeure will delay the performance of an obligation. In that event, the party whose performance has been delayed may be entitled to an extension of time for performance. The contract may specify the extension to which a party is entitled (e.g., one day of extension for each day that performance is delayed), which may or may not yield an equitable result for either party. Alternatively, it may be left to the parties agree upon the extension, if any, that is appropriate. In the case of a construction contract, the con- tractor may be entitled only to an extension of the time for performance if the “**critical path**” schedule is affected. To the extent that the effects of force majeure are absorbed by the float in the schedule, the contractor may not be entitled to an extension at all.

A contract may include provisions aimed at ensuring performance in case of force majeure.

In many cases, the events giving rise to force majeure impose additional costs upon the parties.

The FIDIC forms provide that a contractor who incurs additional costs as a result of force majeure is entitled to the reimbursement of certain costs, in accordance with the contract’s claim procedure. The contractor will be obliged, inter alia, to prove that the costs for which it claims compensation arose from the force majeure events and not some other cause. In the absence of such express contractual provisions, the recovery of costs arising from force majeure is unlikely.

If force majeure conditions prevent performance or delay it for an extended period of time, the contract may be terminated. The conditions upon which this occurs may depend upon the specific terms of the relevant contract.

The FIDIC forms give either party the option to terminate the contract if “***the execution of substantially all the Works in progress is prevented for a continuous period of 84 days by reason of Force Majeure of which notice has been given ... or for multiple periods which total more than 140 days due to the same notified Force Majeure....”***

The rationale for these termination clauses is that the essential purpose of the contract will at some point be frustrated if the contracted work cannot be undertaken for an extended period. The terms of the contract will also stipulate how the work will be wound up in the case of such a termination, and what costs of demobilization, etc., can be recovered.

***SUBCONTRACTORS AND SUPPLIERS***

A major project will normally involve more—perhaps many more—than two parties and one contract. In particular, there may be numerous subcontractors and suppliers. Some of them may be in the country where the project is being per- formed, providing construction materials, for example, while others are located outside the country, designing, manufacturing, and supplying equipment for the main contractor. The relevant contracts may provide for the situation where force majeure conditions in the country where the project is located (e.g., Libya) give the main contractor the right to order suspension of work by a subcontractor that is located outside that country (e.g., Germany) and not directly hindered by the force majeure conditions. The subcontractor will, however, resist an arrangement that causes it to bear the cost of the distant turmoil, as the equipment that it has manufactured may not be suited for an alternative project.

***APPLICABLE LAW***

In addition to considering contractual provisions regarding force majeure, a party should also examine relevant principles of the applicable law. (The applicable law will normally be stipulated in the contract itself.) Unless the contract provides expressly that its force majeure clause supplants the analogous provisions of the applicable law, the contract is likely to be interpreted as supplementing the law on this issue. Thus, general principles of force majeure or frustration of contracts, as the case may be under the applicable law, may be important

If the relevant contract is for the sale of goods, the Convention on Contracts for the International Sale of Goods (CISG) may apply. If so, the principles of force majeure are applicable pursuant to CISG Article 79.

Moreover, the contract may state expressly that the applicable law supplements contractual provisions.

For example, the FIDIC forms provide for remedies under the law governing the contract under circumstances that may not fall within the scope of the force majeure clause. In concrete terms, this means that there may be a basis under the applicable law for terminating the contract that is not available under the terms of the contract.

***DISPUTES***

There is no certainty, of course, that a company’s counter- party will accept a notice of force majeure. The counter- party may contest the existence of force majeure conditions and assert that the company’s nonperformance or delay in performing a particular obligation constitutes a breach of contract. In some instances, the counterparty may make a call upon the performance security that the party invoking force majeure had provided. A prudent contractor will have arranged insurance coverage against the improper calling of performance securities.

The occurrence of force majeure conditions thus increases the likelihood of disputes between contract partners. It is not surprising that a party will attempt to shift the burden of delays and additional costs arising from the turmoil to another party. This situation highlights the importance of the dispute resolution provisions of the relevant contract.

The FIDIC forms provide for arbitration under the ICC Rules, unless otherwise agreed by the parties.

***CONCLUSION***

One can only hope that the troubled times in Libya come to an end soon, with an outcome that opens the way to democ- racy and respect for human rights, but companies active there and elsewhere in the region must be prepared for continuing force majeure conditions. They should accordingly give careful attention to the force majeure provisions in existing contracts, as well as contracts under negotiation. As this brief Commentary has shown, such clauses should define force majeure, taking into account the specific nature of the contract; they should stipulate the actions to be taken in the event of force majeure (such as giving notice and mitigating the effects of force majeure); and they should address the consequences of force majeure, including possible extension of time for performance, recovery of certain costs, and the eventual termination of the contract.

1. [**Force Majeure and Hardship Clauses in International Commercial Contracts.**](http://www.iquesta.com/Memoires-Theses/download.cfm?doc_id=84)**, Béatrice Fleuris**

International contracts: the French courts defined as a contract where there are an ebb and flow across a border, have increased as well.

International trade transactions generally imply a greater element of uncertainty due to the fact that they are subject to political and economic influences in foreign countries. Then, the main difficulty of this kind of contracts is that the circumstances under which they were concluded may well change, and so their performance may be more difficult, for one or more parties.

When such a problem arises, reference is often made to one of the main principles in international law, which is "pacta sunt servanda". It means that once the contract is signed, the parties have to respect it and so to perform it. If one or more party fails to do so, he would be held responsible for this non-execution.

Possible that the situation existing at the conclusion of the contract have changed so completely that the parties, acting as reasonable persons, would not have made the contract, or would have made it differently, had they known what was going to happen.

Nevertheless, some solutions may be found in national laws.

For instance, French law provides that any non-performance of an obligation to do or not to do, do not give right to damages in the case of force majeure. Yet, the courts have applied those provisions in a very strict way, as the application of this provision requires four conditions to be fulfilled simultaneously:

* the event must be "irresistible"
* the event must be unforeseeable.
* the event is to be an outside one.
* the event should be unavoidable and absolutely beyond the control of the debtor.

The Common Law has a wider view and considers the theory of frustration: a contract is said to be frustrated by physical or legal impossibility or by the occurrence of a radical change of circumstances so that the foundation of the contract has gone. The contract is then discharged.

The German approach to the problem is much more flexible. The debtor does not have to fulfil his obligation when it became impossible to perform anymore, as soon as the reason of such an impossibility (*Unmöglichkeit*) is beyond his control, and so not due to his fault or negligence. This impossibility can be physical or legal (such as the compulsory purchase order of an estate). These provisions are quite similar to the Swiss ones.

The Italian theory of the *Presupposizione* is also close to the German one: the contract can be discharged when the situation of the contract becomes, beyond the control of the parties, different to the one that was expected to be.

As this notion does not exist in all the legal system, nearly all *force majeure* clauses have to give a definition of what is a *force majeure* event. If not, such a definition has to be found in accordance with the law under which the contract is concluded.

Usually, contracts provide that *force majeure* is any event that is not foreseeable and is beyond the control of the parties. So, the important point is that the party is unable to avoid the occurrence of an event that was not contemplated by the parties when the contract was made.

If no definition is given, or even in this case, in order to be as accurate as possible, clauses will give examples of *force majeure* or list situations that can be considered as such. There is not a universal and limited list of events, as to the standard events constituting *force majeure*. This list, limited or unlimited, can be very accurate as to the description of such situations, or just list general categories of events. Events that are commonly referred to in force majeure clauses are:

* natural cataclysm, such as earthquakes, fires, storm, tempest, flood, landslides, Act of God (or Act of elements in the contracts concluded with communists countries),
* armed conflicts such as fire, perils and dangers or accidents of the sea, war, warlike operations, civil war, riot, civil commotion,
* Acts of Government (also called “*Fait du Prince*”) such as prohibition of export, impossibility to get the needed permit from the authorities...
* Social conflicts such as strikes, lockout....

In order for the contract to be discharged, the *force majeure* situation must be recognised by all the parties. So, one of the main characteristics of the *force majeure* regime is that, when such an event occurs, a notice must be made by one party to the other one that he considers this event as being one within the field of the *force majeure* clause.

Clauses providing this notice usually provide as well the form and delay in which it has to be made. Sometimes, these clauses also provide the types of evidences that have to be shown

Besides, the clause must provide for the consequences of such a situation on the future of the contract, and for the performance of the contract during the *force majeure* situation. Of course, the debtor of the non-performable obligation will not be liable if this non-performance is due to a *force majeure* event, but what need to be sorted out is what will happen to the contract: is it still performable, or is it considered as void? Usually, as a consequence of a *force majeure* event, the contract will be suspended. A question that then may arise is the one concerning the termination of the contract, especially if the date of the termination occurs within the period when the contract is suspended. In this case, the date of termination has to be changed.

The hardship clause has to contemplate circumstances that have determining consequences as to the economy of the contract. The circumstances can be contemplated in a more or less accurate way, but they will usually be linked to the subject matter of the contract. For instance this situation could be, in a contract on the supply of raw materials, the increase of the price of these raw materials.

In order to be considered as hardship, a situation usually has to incorporate three elements.

* First of all, it must have arisen beyond the control of either party.
* Secondly, it must be of fundamental character.
* And thirdly, it must be uncontemplated and unforeseeable, in the meaning of the probability that such a situation occurs was impossible to assess.

Therefore, one difference between an hardship event and a force majeure event is that, according to the hardship theory, the performance of the contract does not have to be impossible, it just have to be more onerous, burdensome. However, even if the difference seems obvious, sometimes force majeure clauses are drafted in way such as being less demanding of the condition of the impossibility of performance.

The main difference between the two concepts lies in their consequences. Indeed, the aim of the *force majeure* theory is to settle the situation, by suspension or by discharge of the contract, whereas the aim of the hardship theory is to enable the adaptation of the contract to the new circumstances.

Also, in drafting construction contracts can be used the FIDIC Conditions of Contracts for Works of Civil Engineering Construction, published by the Fédération Internationale des Ingénieurs Conseils. What is interesting is that these conditions do not use the wording *force majeure* but their definition of impossibility of performance is quite close to this concept: they define it as a circumstance beyond the control of the parties which makes the contract impossible to perform or unlawful. Indeed, this writing is strongly inspired from the standard clause of *force majeure* as enacted by the ICC, in the fact that in order to be considered as *force majeure*, an event has to be beyond the control of the parties. The FIDIC Conditions also list such events, which would be considered as *force majeure* events: wars, riots, natural disasters etc...

On the contrary, the FIDIC Conditions of Contract for Electrical and Mechanical Works do not hesitate to use the term of *force majeure.* They define it as a «  any circumstances beyond the control of the parties ». This definition is followed by a short but not limited list of examples, in order to help the drafter of the contract in determining what could be an uncontrollable situation. This list is similar to the one in the FIDIC Conditions.

What can also be considered as becoming a usage in their field are the UNIDROIT Principles. These Principles were published in 1994 by the Rome-based International Institute for the Unification of Private Law (Unidroit). They result of more than thirty years of comparative research and worldwide discussion about international contract law. Although not binding, the Principles have been applied by arbitrators in a growing number of cases. These principles consider *force majeure* as well as hardship situations.

The provisions on *force majeure* are quite similar to what is commonly used in international trade. So, the definition given is nearly the same as the one given by the Vienna Convention in its article 79. Though, this definition is very general, and would probably have to be more accurate in the contract. The Principles also provide that the debtor has to give notice to the other party that there is a *force majeure* situation. As regards to the consequences of a *force majeure* event, the parties can either suspend or discharge the contract.

The most audacious provisions are the ones on hardship. => Definition of hardship : a situation where the occurrence of events fundamentally alters the equilibrium of the contract. The event has to occur after the conclusion of the contract, to be beyond the control of the party and to be impossible to take into account by the parties, and the risks must not have been assumed by the party.

The Officials Comments on this Article provide that would be considered as a fundamental alteration an alteration of more than 50% of the value or the cost of the performance. Yet, according to arbitral practice, even if this condition has to be observed, it has never been merely sufficient to justify hardship, and arbitrators will then consider the situation in its whole.

Under the Principles, if there is hardship, the party can request renegotiations.

The first major legal document to be enacted in this field was the Uniform Law for the International Sale of Goods (ULIS), which has been drafted by the International Institute for the Unification of Private Law (UNIDROIT). Article 74 of this law provided an exemption from liability in case of circumstances that the party was not supposed to take into consideration. The main default of such a drafting was that it was then very easy for one party to escape from the performance of the contract as this provision could apply to situation which were not making the contract impossible to perform, but just make it more difficult to perform as what was expected. Anyway, this Convention had a limited success, as only nine countries have ratified it.

The main issue arisen after the enactment of the CISG was to know whether the situation of hardship was contemplated or not. No rule contained in the CISG seems to refer to these situations

Regarding the contracts of carriage of goods, the 1924 Brussels Convention on Carriage of Goods by Sea provides several cases in which the carrier can avoid liability. First of all, he will not be liable in the occurrence of « fortune de mer », which are abnormally unbearable events due to perils and dangers or accidents of the sea

Also, the carrier can avoid liability in case of pre-existing defects of the carried goods predisposing their damage,

The carrier’s liability will also be avoided in case of negligence of the person in charge of the loading of the goods, or in case of act of Government, such as an irregular seizure made by the authorities of a country.

In a quite similar type of contracts, the 1956 Geneva Convention on Carriage of Goods provides that the carrier can avoid liability in case of negligence of the sender or of the receiver of the goods, or of their agents.

Conclusion :

Although their field of application and their legal consequences are theoretically very different, and that according to the theories from which the concepts of *force majeure* and hardship have been developed, modern practice, embodied in official documents, have make these two notions evolve in a way that these differences have diminished. Anyway, what has not changed is that the aim of these two clauses is to deal with the changes of circumstances arising within the performance of a contract.

These two types of clauses have a crucial role, especially in long-term contracts. Indeed, they seem to be a very efficient remedy to a strict application of the principle *pacta sunt servanda* which may lead to unbearable consequences.

Yet, such clauses can always be very difficult to apply. Paradoxically, they may lead to the same insecurity than the one they were supposed to fight, as they are suppose to foresee what is defined as unforeseeable. Nevertheless, while encouraging a more and more accurate drafting, the practice has been able to diminish such a risk and then lead to a nearly optimal application of these essential theories.

1. [**Force Majeure and Hardship Clauses in International Commercial Contracts in View of the Practice of the ICC Court of Arbitration**](http://www.trans-lex.org/126600#toc-1)**, by Werner Melis**

Van den Berg has revealed that court decisions which have so far been rendered on Art. V (2) show a very restrictive interpretation of the term "public policy". This restrictive approach of national courts in denying enforcement of foreign arbitral awards on public policy grounds gives in fact international arbitrators a "supplemental margin of discretion" in the interpretation of the applicable law, which goes beyond the powers available to national judges.

*Force majeure* and "hardship" are exceptions to the basic rule *pacta sunt servanda*. However, a clear distinction of the meaning of both terms in commercial practice is not always easy. There are indeed borderline cases, which cannot be labelled as falling in one or the other basket exclusively. practitioners of international arbitration will also agree that there is a great confusion as to the use of these two terms. Even in important international contracts, they are often inserted as synonyms.

The legal elements for the qualification of an event as *force majeure* (*vis maior*, act of God, etc.) are essentially the same in most legislations, and court decisions show a universal trend to a comparable restrictive interpretation. These elements are (i) that the event is of an external nature, (ii) that it could not be foreseen or prevented and (iii) that it renders performance of a contractual obligation impossible at all or for a certain time.

This cannot be said for the term "hardship" in the meaning of an event that changes the contractual equilibrium between the rights and obligations of the parties in such a dramatic way that performance can become ruinous for one of them or cannot reasonably be expected.

Professor Strohbach, in a parallel study an the same subject , mentions para. 295 of the Gesetz über internationale Wirtschaftsverträge ("GIW") of the German Democratic Republic. This is a modern law, which takes into consideration the necessity to provide for adaptation to changing conditions during the performance of long term contracts. Its provisions primarily aim at an adaptation of the contract to the new situation and a continuation of the contractual relationship.

The above-mentioned ICC cases clearly demonstrate the tendency for international arbitrators to interpret *force majeure* in a very restrictive way. The same Observation is true for "hardship": ICC arbitrators have only exceptionally admitted the application of the principle *rebus sic stantibus*. This restrictive approach is not only visible where French law is applicable a law which is always quoted as an example of strict interpretation of the principle *pacta sunt servanda*, but also when other laws are applied.

The conclusion to be drawn from this is that ICC arbitrators apply at least the same restrictive criteria for admission of *force majeure* or hardship as do courts in the country whose law they apply.

1. **The Hardship and Force Majeure Clauses in International Petroleum Joint Venture Agreements, by TALAL ABDULLA A . Q . ALEMADI**

This piece tries to establish how parties to oil and gas agreements may rely on Hardship and Force Majeure clauses as means of encouraging renegotiation, particularly in cases lacking a contractual term providing for renegotiation. In doing so, I first give a definition of Hardship and Force Majeure clauses. I, then, provide examples form recent practice of both Hardship and Force Majeure clauses. I conclude that Hardship clauses clearly can deal with renegotiation but the traditional view is that Force Majeure clauses deal with suspension or termination of the contracts. I, hence, argued that although the traditional response was suspension or termination of contract, another possible response is renegotiation.

In a traditional sense, Force Majeure clauses exist to solve the problems arising from events that are beyond the control of the parties to the agreement. They tend to give the party the right to request the termination or suspension of the agreement.

E McKendrick *Contract Law*: a clause which “entitles a party to *suspend or terminate* the contract on the occurrence of an event which is beyond the control of the parties and which prevents, impedes, or delays the performance of the contract.”

Hardship clauses, on the other hand, are meant to solve unforeseen events that make performance of the contract more burdensome than initially predicted.

Schmitthoff defines the situations in which the Hardship concept exists by establishing three elements: one, that the event must have arisen beyond the control of the parties; two, that the event must be of a fundamental character; and three, that the event must be entirely unforeseen

The occurrence of unforeseeable and usually unavoidable events. They both also aim to protect the contracting parties from unforeseen and unavoidable events. Both are related to events of a fundamental character that constitute permanent or temporary obstructions and are, therefore, recognised as grounds for being excused from having to fulfil the contract

However, where Hardship clauses differ from Force Majeure Clauses is that **they are meant to be used by parties to an agreement where the contract performance has reached the “limit of sacrifice”, ie in situations where the performance has not become impossible but extremely burdensome**. So, Hardship clauses, unlike some Force Majeure clauses, do not reflect situations which bring the contract to an end when the performance has become too onerous or impossible, Hardship clauses usually seek to re-establish the equilibrium of the contract

El Chiati and Peter, for example, state that Hardship clauses in international business transactions can be “a specific type of renegotiation clause” in that they seek to adjust some of the contractual terms in order to adapt the contractual balance which may have been upset by the unexpected circumstances.

Hardship clauses by definition are designed to allow the relationship between the parties to carry on. Hence, by requesting a meeting to determine whether an event of Hardship has occurred and if so to agree on an adjustment, the parties clearly took extra care in recognizing an obligation on each party to engage in negotiation should a Hardship situation exist.

* re-establish the equilibrium of the contract as opposed to suspension or termination of the contract.
  + + mechanism to reach a mutual agreement

However, Hardship clauses seem to be rare in current oil and gas contracts.

But a well-drafted Force Majeure clause should at least state that the event must be “beyond of the control of the parties,” otherwise, should any dispute arise between the parties, it would become hard to focus on the interpretation of the term “Force Majeure” per se.

The second component is that the clause obliges the parties to give notice to other parties of the agreement, by any method, in which the notice must set forth the particulars of such claimed Force Majeure event or circumstance.

The third component is where the clause provides a remedy as a result of the occurrence of a Force Majeure event or circumstance.

The fourth component might be the most important one. It is where parties not only provide a remedy such as cancellation or extension of the contract, but also clearly insist on ways to overcome Force Majeure events. This fourth component proves that a Force Majeure clause, in the oil and gas industry, can have a wider meaning than the traditional Force Majeure clause.

**Conclusion**

The recognition of changes in circumstances concept does not mean that parties are entitled to adjust a contract by means of renegotiation. It means that parties to oil and gas agreements, even when great attention is paid to choosing a well-defined legal framework which recognises the changes in circumstances concept, should not expect their contractual terms to be easily adjusted. This led me to pick other means on which parties to oil and gas agreement may rely to encourage renegotiation, such as Hardship and Force Majeure clauses. Based on the literature, Hardship clauses clearly can deal with renegotiation but the traditional view is that Force Majeure clauses deal with suspension or termination of the contracts. I, however, argued that although the traditional response was suspension or termination of contract, another possible response is renegotiation. In other words, while Force Majeure clauses do not typically deal with renegotiation, they could be drafted in such a way. Hence, relying on some examples of Force Majeure clauses from practice, we found that they do exist in a wider meaning, and explained that in contrast to the traditional meaning of Force Majeure, those clauses in oil and gas agreements sometimes provide the parties with an opportunity to save much of the expense and efforts spent on the venture. To deal with those clauses in a productive way, however, parties to oil and gas ought to understand this phenomenon. Hence, we argued that it is not enough to rely on widely drafted Force Majeure clauses *per se*, such a clause must explain the steps and actions that a renegotiation obligation entails for the parties. The parties wishing to preserve to themselves a degree of flexibility, in the widely drafted Force Majeure clause, therefore included statements enumerating, for instance, “a duty to make best efforts to solve the Force Majeure events,” or that parties shall “without delay renegotiate the terms of all agreements”. So, parties to oil and gas agreements should lay down what (in the opinion of the parties) steps and actions a renegotiate obligation entails for the parties. Other details, too, such as the consequences of refusing to renegotiate the contract could come from the terms of the contract itself.

1. **Hardship in International construction contracts, Ongoren Law Office**

As in most long term contracts, construction contracts carry some unforeseeable risks. Circumstances might change in the execution of long term contracts so fundamentally that they may alter the contractual. The situation in which the equilibrium of the contract is so frustrated that the execution of the contract might not be expected from one of the parties is called hardship in the practice of international commercial contracts.

Hardship may be a ground for a remedy such as renegotiation of the contract in order to restore the equilibrium or rescission provided that some conditions are satisfied. Accordingly, the frustrating events shall;

a) Lead to an excessive alteration in the equilibrium of undertakings, and this should result in an excessive difficulty or impracticability in the performance of his obligation,

b) Emerge or become known after the conclusion of the contract,

c) Be unforeseeable,

d) Be beyond the control of the disadvantaged party, and

e) The risk shall not be assumed by the disadvantaged party.

Construction contracts are long term contracts by their nature and they are easily affected by natural and economical conditions. For this reason, there is always the possibility that some alterations happen in the execution of these contracts. The remedies in case of an alteration vary depending to the gravity of the alteration.

In case if the requested change is not so fundamental as to frustrate the equilibrium of the undertakings and if the parties show the will to deal with this change within the system of their contract, it would be possible to adapt the contract according to the contractual clauses regarding alterations. The articles of the FIDIC (Fédération Internationale des Ingénieurs-Conseils) Conditions of Contract for Works of Civil Engineering [hereafter FIDIC Conditions] deserve particular attention as being the most referred rules on this matter.

It is not always possible to restore the contractual equilibrium within the system of the contract where a hardship situation renders the performance burdensome for one of the parties

The FIDIC Conditions and the principles evolved in the arbitral case law provide for some remedies for the alterations in the execution of construction contracts. These remedies will be summarised below.

1) Alterations in the execution of the contract under the FIDIC Conditions

The fact that the practice of construction contracts is well established enables the parties to foresee most risks which might affect the execution of the contract. Model construction contracts often contain provisions on how to modify the contract without the intervention of the third persons in case of happening of foreseeable events. The articles 51 and 52 of the FIDIC Conditions are the most applied provisions as FIDIC being the most applied model construction contract. Accordingly, article 51 puts that the engineer is entitled to instruct the contractor to make necessary variations in the name of the employer. The article 52 regulates how to fix the rate or price of the altered works. According to the article 67 of the FIDIC Conditions, the contractor can have recourse to arbitration if he does not agree with the engineer on the indispensability of the variation.

However, in the FIDIC practice it is not always possible to resolve the problems arising from the alterations in the execution of the contracts and/or the valuation of them through negotiations between the parties. The article 67 of the FIDIC Conditions in paragraph one provides for the condition of referring the dispute to the engineer before having recourse to arbitration. In case if the decision of the engineer does not satisfy the parties or the engineer fails to give notice of his decision within eighty-three days, then the parties would be entitled to start arbitration proceedings.

2) Hardship in international construction arbitrations

Transnational rules evolved in the practice of international construction contracts have reached the level of a specific lex mercatoria in this field, with the words of Charles Molineaux, a lex constructionis. One of the principles of the lex constructionis is the principle of rebus sic stantibus. In brief, this principle provides that the parties shall not be bound by the contract in case of fundamental changes in the conditions on which the contract was made.

Conclusion

The execution of construction contracts and the execution of large size projects in particular may take long time and they may be affected by changing circumstances. It may not always be possible to deal with the supervening effects of these changes on the contractual balance within the framework of the system of the contract (and the system of FIDIC Conditions in particular). In such a situation, to ensure the healthy continuation of the contract would be of great importance for the parties. For this reason, the parties are suggested to insert a hardship clause into their contract and enable the arbitrators to resolve their controversies accordingly

1. **Hyperinflation in the construction industry: European “hardship” principles versus the American Doctrine of Impracticability of performance, Daniel D. McMillan**

Rapid escalation in the price of construction materials, highlighted by the well-documented spike in steel prices beginning in 2003, has had a substantial impact on the construction industry in the United States and across the globe. Aside from precipitating lawsuits, bankruptcies, and project cancellations, the hyper-inflationary market conditions of recent years spotlight a somewhat stark divergence in legal principles and contracting approaches between those accepted in the United States and those developing in Europe. This divergence has assumed increasing importance due to the growing European economic influence on projects located in the United States, the expanding presence of American firms on European soil, and the multinational nature of participants on large construction projects throughout the world. American construction lawyers no longer can think of European principles as a matter only of intellectual curiosity. American lawyers are increasingly being asked to provide guidance concerning contract principles that are very much at odds with traditional American approaches.

One glaring difference between contract principles and practices in the United States and those developing in Europe concerns financial hardship resulting from the market risk of hyperinflation. In the United States, the main contract provision used to address market risk is the narrowly tailored price adjustment or escalation clause, which usually applies to specified materials. In the absence of such a clause, a contractor seeking to avoid performance might invoke the doctrines of impracticability of performance or frustration of purpose as excuses for nonperformance—doctrines that seldom (if ever) provide relief for mere increases in price. Developing European principles and contracting practices are much broader. They often authorize termination for hardship or, in the alternative, compelled renegotiation or re- writing of contracts by courts or arbitrators. These approaches to hardship might apply in the case of hyperinflation and deviate dramatically from approaches familiar to most American construction lawyers.

By way of example, the International Institute for the Unification of Private Law (Unidroit) has developed the Unidroit Principles of International Commercial Contracts (UPICC). These principles, first adopted in 1994, and revised in 2004, included a so-called principle of “hardship.” In essence, this principle provides that a party who establishes “hardship” is entitled to request “renegotiation” and, if that fails, a court finding that hardship exists may: (i) terminate the contract; or (ii) “adapt the contract with a view toward restoring its equilibrium.” The UP- ICC defines “hardship” as “the occurrence of events” that “fundamentally alter[ ] the equilibrium of the contract . . . because the cost of a party's performance has increased,” provided that four other factors are satisfied, factors similar to those underlying the doctrines of impracticability and frustration in the United States. More significantly, the UPICC hardship principle: (i) applies to any event that causes the cost of a party's performance to increase (not just price escalation); and (ii) authorizes a court to terminate the contract or essentially rewrite the contract to restore the “equilibrium of the contract.” This is a significant departure from the traditional approach to construction contracts in the United States and one with significant potential implications.

At the same time, as the recent hyperinflation was taking place, enormous consolidation was occurring among construction and engineering forms. European companies were acquiring construction forms based in the United States, and European-based construction forms have been and continue to take a more active role in large construction projects in the United States. Similarly, large multinational corporations based in the United States, whether in the energy sector or the pharmaceutical sector, are contracting outside the United States more frequently with European owned contractors. As a result, European contracting principles are being pressed in a variety of contracting contexts, and it is not unusual for a European participant on a project to request application of, or incorporation of, the UPICC hardship principle as a response to escalation concerns. American lawyers, therefore, need to be able to respond to client inquiries about approaches like those reflected in the UPICC hardship principle.

This article addresses legal issues associated with hyperinflation and contrasts the traditional American approach with the approaches reflected in the UPICC hardship principles and certain other European rules. The article begins with a look back at the impact of hyperinflation that has characterized the construction industry in recent years. That retrospective is important in evaluating how to deal with economic pressures in the future and provides the background for contrasting approaches to dealing with such matters and the legal doctrines that might apply. The article next discusses the legal doctrines frequently used when a contractor seeks to avoid contractual obligations in the face of hyperinflation, including impossibility and impracticability of performance, frustration of purpose, the legal doctrine of mistake, and contractual force majeure clauses. Also discussed are three cases, decided recently, addressing at- tempts by contractors to avoid the contractual obligations in the context of the escalation in steel prices—cases that will be instructive to lawyers confronting similar circumstances. Next, is a brief discussion of contractual and other approaches to allocating the risk of escalation, including force majeure clauses, the various types of price escalation clauses, and other strategies to managing the risk of escalation. Lastly, this article discusses the UPICC hardship principle and compares it to the doctrines of impracticability and frustration. As the world becomes flatter, familiarity with developing and competing approaches to allocating risk becomes more important for construction lawyers based in the United States

CONCLUSION

The recent spike in steel prices and other construction materials has brought into focus a rather significant difference in legal doctrines and contracting approaches between the U.S. and Europe. In the United States, the doctrine of impracticability provides relief from changed circumstances. Contracting parties have used narrowly tailored price escalation issues to allocate the risk of hyperinflation. In contrast, the trend emerging from Europe, as exemplified by the UPICC hardship principle, entitles a party to a contract to request renegotiation in the event of hardship and expressly authorizes courts and arbitrators to adapt the contract to restore the “equilibrium” of the contract. This is a dramatic departure from American jurisprudence and contracting practices within the United States where renegotiation and judicial adaptation clauses rarely and their way into construction contracts. The globalization of the construction industry, however, means that there will be collisions between these competing approaches, especially as the UPICC hardship principle continues to and commercial acceptance. American construction lawyers need to be familiar with the UPICC hardship principle so they can advise clients who encounter this principle. The UPICC is coming to a town near each of us. It is time to read the reviews.

1. **Change of Law - Checklist and Sample Wording**

The operator should be obliged under the Contract to comply with all applicable legislation. The cost of complying with legislation which is current or foreseen at the time of the Contract should be built into the price, and so be the responsibility of the operator. Given the long-term nature of most PPP arrangements, the operator may not be capable of including in the price specific costs arising from changes in law which are not foreseeable at the time of entering into the Contract. In PPP arrangements involving third party financing, the lenders are also going to be concerned that the Contract provides for the possibility of a change in law. The Contract needs to address who should be responsible for the costs arising from changes in law and how such costs should be funded.

The Operator’s concern is that change of law is a risk which it cannot control and which it regards as being more within the control of the public sector or Awarding Authority, although this will not necessarily be the case given that the Awarding Authority may be a local or other entity with little control over state-wide legislation that may have implications on the Contract

The Operator will be anxious to ensure that it is compensated and/or is able to exit from the Contract in the event that the rules upon which he relied when submitting his bid are changed and this change has an adverse impact on his ability to perform the contract or his financial return from the contract.

The key issues that should be considered when drafting or reviewing a change of law clause are:

The date from which changes are relevant

Definition of “change of law”

Allocation of risk of change in law

What is to be the outcome if the impact of the change of law is such that the contractor can no longer perform the contract, even at a greater price

Who will determine whether a change of law has occurred and any changes in contract price

“Applicable law” means laws and any other instruments/ subordinate legislation having the force of law [or having been published[1] in [relevant country]. For the avoidance of doubt, Applicable Law shall include any applicable statute, ordinance, decree, regulation, or by-law or any rule, circular, directive or any licenses, consent, permit, authorization, concession or other approval issued by any authority which has appropriate jurisdiction.

“Change of Law” means the coming into effect after [the date of this Contract][bid submission date][other date] of:

Applicable Law; or any applicable judgment of a relevant court of law which changes the interpretation of the Applicable Law [and is a binding precedent] which [directly and adversely] affects the Contractor’s performance under the Contract [in a material way].

“Specific Change in Law” means any Change in Law which specifically refers to the provision of [services the same as or similar to the Service] or to the holding of shares in companies whose main business is providing [services the same as or similar to the Service].

“General Change in Law” means a Change in Law which is not a Discriminatory Change in Law or a Specific Change in Law.

“Qualifying Change in Law” means:

(a) a Discriminatory Change in Law;

(b) a Specific Change in Law; and/or

(c) [a General Change in Law which comes into effect during the Service Period and which involves Capital Expenditure,] which was not foreseeable at the date of this Contract.

Qualifying Change in Law

(a) If a Qualifying Change in Law occurs or is shortly to occur, then either party may write to the other to express an opinion on its likely effects, giving details of its opinion of:

(i) any necessary change in Service;

(ii) whether any changes are required to the terms of this Contract to deal with the Qualifying Change in Law;

(iii) whether relief from compliance with obligations is required, including the obligation of the Contractor to achieve the Planned Service Commencement Date and/or meet the [performance regime] during the implementation of any relevant Qualifying Change in Law; (iv) any loss of revenue that will result from the relevant Qualifying Change in Law;

(iv) any Estimated Change in Project Costs that directly result from the Qualifying Change in Law; and

(v) any Capital Expenditure that is required or no longer required as a result of a Qualifying Change in Law taking effect during the Service Period,

(b) in each case giving in full detail the procedure for implementing the change in Service. Responsibility for the costs of implementation (and any resulting variation to the Unitary Charge) shall be dealt with in accordance with paragraphs (b) to (f) below.

(c) As soon as practicable after receipt of any notice from either party under paragraph (a) above, the parties shall discuss and agree the issues referred to in paragraph (a) above and any ways in which the Contractor can mitigate the effect of the Qualifying Change of Law, including:

(i) providing evidence that the Contractor has used reasonable endeavors (including (where practicable) the use of competitive quotes) to oblige its subcontractors;

(ii) to minimize any increase in costs and maximize any reduction in costs;

(iii) demonstrating how any Capital Expenditure to be incurred or avoided is being measured in a cost effective manner, including showing that when such expenditure is incurred or would have been incurred, foreseeable Changes in Law at that time have been taken into account by the Contractor;

(iv) giving evidence as to how the Qualifying Change in Law has affected prices charged by any similar businesses to the Project, including similar businesses in which the Shareholders or their Affiliates carry on business; and

(v) demonstrating that any expenditure that has been avoided, which was anticipated to be incurred to replace or maintain assets that have been affected by the Qualifying Change in Law concerned, has been taken into account in the amount which in its opinion has resulted or is required under paragraph (a) (v) and/or (vi) above.

(d) If the parties agree or it is determined under Clause 28 (Dispute Resolution) that the Contractor is required to incur additional Capital Expenditure due to a Qualifying Change in Law (excluding the Contractor’s Share of any Capital Expenditure agreed or determined to be required as a result of a General Change in Law under this paragraph), then the Contractor shall use its reasonable endeavors to obtain funding for such Capital Expenditure on terms reasonably satisfactory to it and the Senior Lenders.

(e) The Contractor’s Share shall be solely for the account of the Contractor.

(f) If the Contractor has used reasonable endeavors to obtain funding for Capital Expenditure referred to in paragraph (c), but has been unable to do so within [60] days of the date that the agreement or determination in paragraph (c) occurred, then the Authority shall pay to the Contractor an amount equal to that Capital Expenditure on or before the date falling 30 days after the Capital Expenditure has been incurred.

(g) Any compensation payable under this Clause by means of an adjustment to or reduction in the Unitary Charge shall be [see Section 5.2.3 (Calculation of Compensation) above].

1. **Variations to contracts and changes in the law**

It is common in commercial contracts to include a provision that any changes made to a contract are ineffective unless made in writing and signed by or on behalf of both parties. This is known as a variation clause, and is intended to prevent informal or inadvertent oral variations. However, common law allows for a written contract to be changed by subsequent mutual agreement from both parties, whether oral or written.

Similarly, changes in the relevant law can affect the way work is performed under a contract. Contractors will generally be obliged to complete the work in accordance with local building regulations and other laws. If the law changes during the term of a construction project, this can have cost implications for the contractors.

**Variations - the common law position**

As long as the law or the contract itself does not say otherwise, parties to a contract can change it by oral or written agreement.

But for this variation to be effective there must be:

* a valid agreement between the parties – mere notification by one party to the other is not effective;
* some form of consideration supporting this agreement.

This consideration could take many forms, for example:

* mutual abandonment of existing rights;
* new benefits being granted by each party to the other party;
* the parties assuming additional obligations if the contract is breached.

If a contract has a clause in it which prohibits oral variations then those variations will generally be ineffective. However, this does not mean that the parties cannot change their arrangements orally even in the face of such express contractual wording. This can happen where the parties have expressly agreed to vary the term prohibiting oral variations, or if one party can show waiver or estoppel.

**Waiver** is where one party voluntarily agrees to a request by the other not to insist on the precise performance method outlined in the contract.

A waiver can be oral or written, or can even be inferred by conduct - so a party can waive (or be taken to have waived) its right to rely on a written variation where the way it has acted after the contract has been varied by oral agreement.

**Estoppel** similarly prevents a party from relying on a clause requiring any variations to the contract to be made in writing. For this to be effective there must be:

* a clear and unequivocal representation;
* on which the other party must have relied; and
* on which the other party has altered its position

The practical effect of a prohibition on oral variations will therefore depend to a great extent on the evidence available about the intention of the parties and their actual course of conduct.

An exception to this general rule is that a contract which is required by law to be made or evidenced in writing - for example, consumer credit or consumer hire agreements – can only be varied in writing.

**How construction companies deal with variations**

We have looked at how companies in general deal with changes to the work outlined in a contract. In construction, though, a distinction is made between:

* amendments to the contractual provisions; and
* variations of the actual work instructed by an employer

Amendments to a construction contract will generally be made by written agreement between the parties and will be amendments to the contractual provisions not including the scope of work to be undertaken.

Variations on the performance of that work will, on the other hand, usually be made according to a variation procedure drafted into the contract terms. This is because construction projects will usually be so large and take such a long time to perform that it is administratively less of a burden to the parties to agree a variation procedure in advance, so that an amendment to the contract doesn't have to be made every time the scope of the work changes.

Providing the variation is made in accordance with the correct procedure, there is no need to change the actual terms of the contract. Accordingly, there is no need to prove that consideration has been provided for that amendment to be effective.

**Changes in law – the common law position**

In the absence of express provisions to the contrary, there is normally an implied term in a contract that the contractor will not complete the work in a manner which contravenes relevant building regulations or other construction laws. However, whether a contractor can recover any associated costs depends on whether:

* the work for which the contract sum is payable is defined in terms wide enough to include work which is unspecified in the contract, but necessary to comply with building regulations; and
* where the contract work is not defined in such wide terms, whether the contractor sought the employer's instructions before carrying out the unanticipated work necessary to comply with the building regulations or whether the contractor can show a promise to pay.

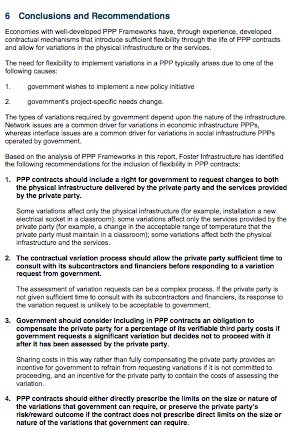
Where the contract is for a lump sum, the courts will tend to infer a promise on the contractor's part to provide everything necessary to complete the whole work – including everything necessary to comply with building regulations and other relevant laws.

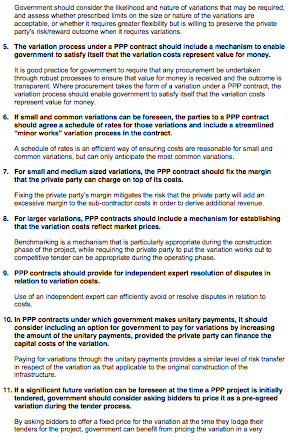
**Construction contract approach to changes in law**

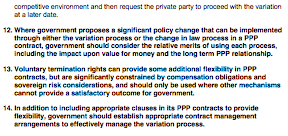
Construction contracts will generally expressly provide for how to deal with the effects of changes in law on a project.



1. **Comparative Study of Contractual Clauses to Provide for the Smooth Adjustment of Physical Infrastructure and Services through the Lifecycle of a Public-Private Partnership (PPP) Project, Foster Infrastructure**







1. **Compilation of PPP Terms and conditions of contract public sector version clause 35: Change in law**

In a PPP contract, change of law risk is usually shared. The PPP Co will be compensated for the cost of certain changes. Usually “discriminatory” changes of law are public sector risks. This means laws that discriminate against the project, or against PPP-type projects. In some projects, specific laws or other standards of particular relevance to the project are also covered.

Second, most PPP contracts provide for the Authority to take a share of *capital costs* incurred because of changes in law *after the construction is complete*. In some cases the PPP Co tenders the share of change of law risk it will take: this tendered percentage is used as a factor in assessing the most economically advantageous tender. If this approach is taken, it is important to ensure that the PPP contractor will have adequate resources – such as a standby facility – to meet this obligation.

The key commercial issues of allocation of change of law risk are usually reflected in the definitions. There is also a schedule dealing with the procedures. Below, we set out the drafting of the Core Contract definitions and the schedule, and some slightly different approaches reflected in the definitions in the Accommodation and Operating Contracts.

General changes in law absorbed by the PPP Co, in the most part, can be reimbursed when conducting benchmarking and market testing exercises.

DEFINITION OF CHANGE IN LAW

The Contract should specify that the Contractor is expected to comply with all relevant law and should contain a mechanism for handling the effects of a change in law.

ALLOCATION OF RISK OF CHANGE IN LAW

In some projects, it is possible to treat changes in law of any type as the Contractor’s risk. This has occurred in particular in projects in which such costs can be passed on to the users of the Project (e.g. toll bridges).

In other sectors, a risk sharing approach has developed where the main user of the Project is the Authority and it is not appropriate for the Contractor to bear all of the change in law risks as the risk cannot be quantified or passed on to third party users. There are a number of different possible approaches to risk sharing that build on the distinctions between discriminatory/specific legislation and general legislation. These all involve a sharing of the risk of changes in law.

MITIGATION

Whenever the Authority bears some of the risk of a change in law, the Contractor should be obliged to

keep any cost increases to a minimum.

Cours 9 & 10

1. **Liquidates damages and the doctrine of penalties: rethinking the war on terrorem, Matthew Bell**

It is the underlying premise of this paper that, where commercial parties have freely agreed, within a binding contract, to a regime for liquidated damages (‘LDs’) which is expressed in terms sufficiently certain to be enforced, the law should uphold its enforcement upon those terms. Such a notion serves a desirable commercial purpose in that it allows parties to anticipate with maximal certainty the remedial consequences where the contract is breached. It is also consistent with the underlying rationale for the enforcement of contracts which seeks to ensure that obligations are undertaken freely and, once such voluntariness is established, allows for minimal interference by the courts.

English courts have for many years sought to act in a manner consonant with this rationale. As was observed by Lord Woolf, for example,‘... the court has to be careful not to set too stringent a standard and bear in mind that what the parties have agreed should normally be upheld. Any other approach will lead to undesirable uncertainty especially in commercial contracts.’

In turn, the modern approach places a high barrier in the path of a party seeking to overturn an LDs provision on the basis that it is penal. It looks to whether ‘the predominant contractual function of the provision was to deter a party from breaking the contract or to compensate the innocent party for

breach.’ Even where a penal intent is discerned, the court may have regard to whether the provision is, nonetheless, ‘commercially justifiable’.

However, the jurisprudential foundations of the penalty doctrine remain, in the words of appellate-level judges, ‘anachronistic’, ‘pragmatic rather [than] principled’, and an ‘anomaly’ within the law of contract. Thus, parties seeking legal advice as to the way in which they can frame their LDs provisions often receive it with ‘incredulity’.

From a commercial point of view, perhaps the most counter-intuitive aspect is that the law maintains a prohibition upon parties using LDs provisions to enforce performance by placing the other in fear – *terrorem* – of breach. This is especially difficult to rationalise in view of contemporary contracting approaches in the construction industry which embrace the potential for risk sharing and therefore assume that the parties are able to tailor a risk-reward scheme geared towards ‘best for project’ outcomes. Indeed, whilst it has become common parlance in certain sectors for LDs to be regarded as a mechanism to ‘incentivise the [c]ontractor’, it remains the case that a party cannot justify an LDs provision on that basis.

This paper argues that the prohibition upon deterrence is an element of the doctrine of penalties which has outlived its usefulness. It does so within the following structure:

* Part B describes the commercial impetus for the use of LDs provisions in construction contracts;
* Part C outlines the history, and current state, of the law relating to deterrence within the penalty doctrine;
* Part D offers a critique of the current law; and
* Part E proposes, by way of conclusion, an alternative formulation of the doctrine of penalties based upon whether the allegedly penal component serves a purpose other than the proper performance of the contract.

**B.The commercial impetus for LDs in construction contracting**

***LDs as a risk mitigation measure***

The common law and equitable principles governing the enforceability of LDs apply generally (though not necessarily uniformly) across commercial contracts.

This widespread use of LDs may be seen as reflecting the ‘good business sense’ of seeking up-front certainty of remedial outcomes by avoiding the exigencies of court or arbitral processes. This benefit has been recognised since at least the late eighteenth century,18 and potentially applies to both the employer and the contractor and also throughout the contractual chain. Indeed, it has been proposed that the benefits of LDs extend beyond the parties, with economic efficiency being broadly promoted through resources being put into up-front negotiation rather than litigation.

Specifically, parties seek to gain certainty at the start of the project as to (in the case of those doing the work) their potential liability and (in the case of those for whom the work is done) their ability to recover in the event that the default the subject of the clause is triggered.

Parties are, therefore, seeking to rely upon the twin assumptions underpinning the legal principles:

o first, that, where enforceable, liquidated damages will provide a limitation upon the claimant’s right of recovery (that is, the LDs

set a cap upon damages for that event such that the claimant cannot claim compensation at general law for its losses to the extent they exceed the applicable LDs); and

o second (and conversely), that the claimant is entitled to recover LDs in accordance with the contractual mechanism even where its actual losses in the circumstances are less than the amount available as LDs.

Moreover, the losses recoverable by way of liquidated damages may exceed those which would otherwise be legally recoverable – for example, they may include losses which would be irrecoverable due to the operation of common law principles of remoteness or mitigation.

The setting of LDs is, therefore, akin to other staples of the construction contracting landscape (such as lump sum rather than reimbursable remuneration and the use of limitations of liability) which seek, to the extent possible, to privilege up-front certainty as to outcomes over the gamble of leaving the parties to their general law rights in circumstances as they actually unfold during the contract.

The level of LDs which applies is a function not only of the relative bargaining strengths of the parties to that contract but also is influenced by factors operating generally within the relevant contracting sector or region.

Thus, LDs play a critical role in the overall risk/reward matrix applicable to construction contracts. In turn, parties acting in an economically rational manner in negotiating such contracts may reasonably hold an expectation that the law will – as it does, for example, in relation to whether the contract price represents adequate consideration – place minimal restrictions upon the legal enforceability of the bargain which is struck.

***Challenges to enforceability***

The benefit of up-front certainty, noted above, may well be generally understood and, to varying extents, held to at the time of entry into the contract. However, it tends to revert to an abstract concept when construction risks place the stipulated completion date in jeopardy. In these, all too frequent circumstances, the contractor may find that even a modest daily rate of LDs leaves it *prima facie* vulnerable to a substantial claim in the aggregate. On the other hand, the employer may find that the LDs available to it are substantially less than its actual loss. Inevitably, the legal enforceability of the LDs provision will then be put under scrutiny.

It is important to recognise, as a starting point, the high commercial stakes which are bound up within the various tests as to whether a purported LDs clause is enforceable. As was noted by Buxton LJ, there is ‘no middle ground’: the claimant will either be entitled to the entirety of the amount calculated by reference to the mechanism or left to prove its actual loss in accordance with the general law.

Perhaps the most common ground on which the mechanism is challenged, however, is *via* the route which is the focus of this paper: the doctrine of penalties.

**C. Evolution of the doctrine of penalties**

Blair J in the English High Court recently remarked that the ‘law as to penalties is well settled’. His Honour’s statement is, with respect, entirely true: generally speaking, and as is reflected in the modern cases noted below, the key principles are applied in a fairly consistent manner. The fact the statement is able to be made is, however, remarkable because those principles are, to a substantial extent, based on less than solid legal foundations. Indeed, commentators have variously described the doctrine as a whole as presenting ‘a confused and contradictory state’ and its underlying rules as ‘a jumble of historical curiosities which out of context provide no unitary rationale’.

***Pre-*Dunlop *history***

The law relating to penalties has long been recognised as being ‘obscure and not easily traced to any very exact source’

Indeed, even after the Reformation and the dwindling of clerical influence upon the English courts, the Courts of Equity are said to have remained suspicious of ‘penal bonds’, perhaps because they were brought to England by Italian bankers.

This was that, as expressed succinctly by Young LJ in 1881, ‘the law will not let people punish each other’.

***The* Dunlop *test***

On 28th June 1914, a shot rang out in Sarajevo, assassinating Archduke Ferdinand and precipitating events which were to change the course of twentieth century history. Three days later, in London, an event occurred which has had equivalent resonance within the (admittedly, somewhat more limited) sphere of the law of penalties: the House of Lords handed down its ruling in *Dunlop*

Whilst opinions were provided by each of the Law Lords – all allowing the appeal and therefore upholding the enforceability of the liquidated damages in question

The seminal nature of Dunedin LJ’s judgment rests upon his having identified and described four ‘authoritative’ propositions in relation to the doctrine of penalties which aggregated the then existing law. These included (propositions 2 and 3):

‘The essence of a penalty is a payment of money stipulated as *in terrorem* of the offending party; the essence of liquidated damages is a genuine covenanted pre-estimate of damage ... The question whether a sum stipulated is a penalty or liquidated damages is a question of construction to be decided upon the terms and inherent circumstances of each particular contract, judged of as at the making of the contract, not at the time of the breach.’

His Lordship went on to note various tests ‘[t]o assist this task of construction, which if applicable to the case under consideration may prove helpful, or even conclusive’. These included that it ‘will be held to be a penalty if ...’

‘4(a) ... the sum stipulated for is extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from the breach ...[or] 4(b) ... the breach consists only in not paying a sum of money, and the sum stipulated is a sum greater than the sum which ought to have been paid.’

That said, the collateral purpose rationale retains some resonance in modern case law. For instance, Diplock LJ referred to the need not to:

‘... offend against the equitable rule against penalties; that is to say, it must not impose upon the breaker of a primary obligation a general secondary obligation to pay to the other party a sum of money that is manifestly intended to be in excess of the amount which would fully compensate the other party for the loss sustained by him in consequence of the breach of the primary obligation.’

***Current approaches to the deterrence element***

The two statements as to the ‘essence’ of the doctrine set out in Dunedin LJ’s proposition 2 above may be regarded, on their face, as having the potential to be mutually exclusive. However, subsequent consideration has confirmed that they form a double sided coin. In other words, consistent with the notion that both sides of the test rest upon a process of construction of the contract (proposition 3), the question of whether the offending party is placed *in* *terrorem* is not at large or to be determined subjectively. Instead, the analysis is generally by reference to the level of disproportion between the sum stipulated and the maximum conceivable loss (4(a))

The objective nature of the test has been emphasised, for example, by confirmation that the court will not look (under the umbrella of ‘unconscionability’ referred to by Dunedin LJ) to whether the bargain itself is unconscionable. Rather, as was noted by Lord Wright MR, ‘[i]t is merely a synonym for something which is extravagant and exorbitant’.

Thus, the modern approach rests upon using the ostensible ‘genuineness’ of the pre-estimate as a proxy for whether the provision is a deterrent*.*

Colman J in *Lordsvale Finance*:

‘... whether a provision is to be treated as a penalty is a matter of construction to be resolved by asking whether at the time the contract was entered into the predominant contractual function of the provision was to deter a party from breaking the contract or to compensate the innocent party for breach. That the contractual function is deterrent rather than compensatory can be deduced by comparing the amount that would be payable on breach with the loss that might be sustained if breach occurred.’

By way of recent application, this principle was the foundation upon which the English Court of Appeal held, in a charterparty case in 2009, that a component of contractually stipulated damages was penal.

They may, however, be explained by the observation of Jackson J (as his Lordship then was) in *Tilebox*, that, whilst the ‘genuineness’ of the pre- estimate is ‘primarily’ to be determined objectively, the court may have ‘some regard to the thought processes of the parties at the time of contracting.’ The latter notion, referred to as ‘commercial justification’, has subsequently been expanded upon in the English courts, notably by Arden LJ in *Murray*, who included, as an item in her Ladyship’s ‘step by step guide’ to whether a provision is penal, ‘the parties’ reasons for agreeing to the relevant clause’

**D. Satisfactory outcomes built on unsatisfactory foundations?**

The modern approach, outlined above, exposes the dilemma faced by courts and the law generally in the light of the continued currency of the deterrence prohibition in the terms set by *Dunlop*.

On the one hand, courts are disinclined – both for resourcing reasons and also in order to promote freedom of contract and contractual certainty – to hear arguments by parties that they should not be bound to the bargain which they apparently have struck. This imperative also supports the need to ensure that any analysis is on an objective basis rather than seeking to ascertain the parties’ actual intentions.

The current consensus appears to be that the balance is, on the whole, being struck appropriately. As was noted recently by Solene Rowan, for example, on the basis of an extensive survey of the case law,

‘... [p]arties of comparable bargaining power that enter into commercial contracts can now expect that as long as their agreed damages provisions are not extravagant they are unlikely to be the subject of judicial intervention. A *reasonable* deterrent effect is tolerated.’

The lack of guidance is reflected in the divergent outcomes provided when the same set of facts is examined by different tribunals. For example, in respect of a contract to build a road in northern Tasmania, the rate of LDs was regarded by the trial judge as incorporating ‘purely speculative’ elements and therefore the provision was struck down as a penalty.89 On appeal, that was said to be ‘an incorrect application of principle’ and the LDs were enforced.91 In *Dunlop* itself, the sum stipulated was held to be LDs before the Master, a penalty by the Court of Appeal and once again LDs in the House of Lords.

The prospect of such variable results – and, indeed, of the need to litigate to an appellate level in order to receive a binding outcome – is anathema to the goal of commercial certainty which, as noted above, underpins the use of LDs.

**E. Conclusion: back to the future?**

***Considerations underpinning a revised formulation***

The cases discussed above indicate that English courts currently seek to uphold, by way of result, the primacy of the parties’ agreement to the greatest extent possible. However, so long as the compensatory model, with its underpinnings in the prohibition upon deterrence, continues to provide the philosophical foundation of the doctrine of penalties, a gap inevitably must remain between the parties’ desire to legislate for their own remedial structure and the law’s ability to provide a certain framework within which that goal may be delivered.

If an alternative formulation is to be proposed, however, it needs to be not only ‘principled and based upon clearly articulated policy foundations’, but also to accommodate a number of issues which have a tendency to conflict. These include:

* crucially, the promotion of flexibility for parties to strike their own commercial deal and in having that deal legally upheld;
* a recognition of the commercial reality that, most usually in the construction industry, parties do not ‘satisfy [their] contractual hunger à la carte but only at the table d’hôte of a standard printed contract’, and that these forms are often not read before being signed, yet the law will deem the parties to be bound to them
* there in fact being an ongoing need to maintain the penalties doctrine in some form;
* the desirability, on economic efficiency grounds, of encouraging parties to specifically consider and agree the remedial regime for a particular contract:
* an associated benefit of such up-front consideration – especially where it is undertaken in good faith – being that parties may more credibly be assumed to have freely entered into their agreement

In addition, given the critical role played by LDs within commercial contracting generally, any reconsideration of its jurisprudential basis ought not to do violence to the existing body of case law.

***A return to the collateral purpose test?***

It is proposed that the collateral purpose concept, though centuries old and lately eschewed, may well strike an appropriate balance between these considerations, rendering it suitable as a guiding rationale for the future development of the doctrine of penalties.

It will be noted that the key proposed change is to replace the ‘double sided coin’ of deterrence and compensation with a broader enquiry into the commercial purpose of the contract. The consequential change is the elimination of the presumption that the primary means of analysis is upon the disproportion between the stipulated and otherwise recoverable damages.

Bringing penalties analysis under the broad umbrella of contractual construction, rather than its current *sui generis* location (especially, as noted above, in relation to ‘commercial justification’), ought of itself to promote commercial certainty. However, it does need to be anticipated that the subsumption of the commercial justification test would, under the law as it currently stands, lead to fewer opportunities for parties to introduce evidence, extrinsic to the contract, about the purpose of the LDs provision.

Thus, if the revised concept were adopted, it may be expected that the parties’ attention would be re-focussed upon the ‘four walls’ of the contractual documentation rather than, for example, upon keeping file notes of the commercial purpose behind the LDs. It would, however, reinforce the existing wisdom under the current formulation that the parties actually turn their minds to the LDs provision rather than stipulating, for example, a set percentage of the contract price for all projects. Beyond that, though, it ought to encourage parties to ensure that sufficient guidance is provided to the tribunal, within the contract itself, to explain the commercial intent of the clause. This naturally presents challenges within standard form contracting, but many such contract-specific matters are already provided for in ‘contract particulars’, annexures and the like.

These implications in relation to construction of the LDs provision are but one example of issues which would need to be considered in detail if the revised formulation described above were to gain currency. It is, nonetheless, submitted that the proposal is worthy of such consideration as a means of dispatching the anomalous prohibition upon deterrence whilst maintaining a role for the doctrine of penalties in quashing anti-commercial LDs clauses. Thus, and with apologies to Arden LJ for adapting her phrase, reinvigoration of the collateral purpose test offers an opportunity to develop a jurisprudential foundation for the doctrine of penalties which is both pragmatic *and* principled.

1. **The lawyer’s role in securing the provisional acceptance of the works, Pierrick Le Goff**

The provisional acceptance of the works, commonly referred to among construction law practitioners as the “PAC” or the “Taking-Over”, is a critical phase of any major construction project.

It has been defined by Dr Iur as “the act through which the project owner, having verified the substantial completion of the works and their compliance with the technical specifications, accepts them following adversarial discussions with the construction contractor and formulates, as may be required, certain reserves on the quality of the works to be taken into account by the contractor”.

Rightfully, some scholars describe the taking-over process as the “cornerstone” or the “culminating point” of the project.

This is certainly due to the fact that several important consequences are linked to the achievement of the PAC.

* Transfer to the project owner of the risk of loss of or damage to the works;
* Payment of the PAC milestone payment;
* Return of the performance bond and, when applicable, replacement of such bond by a warranty bond;
* Start of the warranty period;
* Establishment of the reference date for the assessment of possible project delays and the applicability of delay liquidated damages.

The owner will not wish to trigger such consequences, and their related financial aspects, unless there is certainty about the fulfilment of the conditions leading to the PAC. The contractor, for its part, will not easily accept any unjustified postponement of the issuance of the taking-over certificate, since such delay would severely affect the project cash flow and risk profile.

The PAC phase is therefore prone to serious frictions between the parties and contributes to the high risk of disputes, which many scholars consider to be one of the main characteristics of major construction contracts. Obviously, a clear and balanced contractual basis helps reduce this risk, and enables dealing more efficiently with such risk if it ever materializes during the project.

However, the risk mitigation in this matter does not end with the finalization of the various contract documents. To a certain extent, it really starts when the contract is signed and the parties gear up toward project execution. As a result, lawyers involved in the project, be it on the seller’s or the buyer’s side, can bring their professional expertise either by implementing measures for a better prevention of PAC disputes, or by developing strategies to reach amicable solutions once a crisis has occurred. The analysis of this important role, which lawyers can play in construction management and execution for the collective benefit of all parties involved, is the subject of this article

**I) Securing the PAC through preventive measures**

Prevention starts with a sound contractual basis. The first major input of the lawyer in securing the PAC will consist in ensuring an adequate drafting of the taking-over clause (A). When the project starts, this clause will need to be properly applied (B).

1. **Drafting the taking-over clause**

The difficulty with the drafting of the taking-over clause is that it requires a good knowledge of the business environment, of standard practices in the relevant industry, and of the general technical characteristics of the Plant. Deficient knowledge in any of these areas may lead to loopholes in the applicable contract provisions and the relevant technical exhibits.

As Professor Böckstiegel has outlined in this context, a closer look at construction disputes shows that a greater involvement of lawyers during the contract drafting and negotiation phase would have enabled in many instances to avoid the conflict situation

1. Defining the parties’ obligations relating to the PAC phase

In broad terms, the Contractor’s obligations center around the delivery of a Plant conforming to the technical specifications and meeting the guaranteed performances

Less obvious, though, is the definition of the Owner’s obligations required to allow a successful taking-over of the Plant. This might be due to the recurrent misconceptions around the notion of “turnkey”. For the sake of convenience, turnkey construction projects are often described in general terms as meaning that the Contractor is to perform the works in such extensive manner as to allow the Owner to simply “turn the key” in order to be able to operate the Plant.

Professor Le Tourneau reminds us quite rightfully however that the term “turnkey” is, in this respect, rather misleading. Even for construction projects on a turnkey basis, the Owner is to perform a whole array of obligations in order to enable the Contractor to fulfill its own obligations toward achieving PAC.

the Owner’s obligations that are directly relevant to the achievement of the taking-over of the Plant should include in particular:

* granting access to the construction site;
* obtaining the consents, approvals and other applicable authorizations required from the Owner by government authorities in order to carry out the trial run and performance tests;
* making available on the construction site the agreed utilities for the completion of the works, such as electricity or water;
* providing the required raw materials or other energy sources for the operation of the Plant during the trial run and performance tests, such as fuel, gas, limestone and the like;
* ensuring the offtake of electricity generated during the trial run and performance tests;
* making available operating personnel with the required qualifications for the commissioning and operation of the Plant during the trial run and performance tests.

1. Defining neutral and balanced conditions toward achievement of the PAC

The potential for disputes and conflicts during the taking-over phase can be reduced if the conditions toward achieving the PAC are expressed in neutral and balanced terms. Engineers involved in the project negotiation may sometime have a tendency to express their technical expectations in an ideal but unrealistic way.

example here is the expectation from the Owner’s consulting engineer that the Plant be built in compliance with A good example here is the expectation from the Owner’s consulting engineer that the Plant be built in compliance with applicable laws and regulations. As such, this expectation is reasonable and understandable, but it may lead to an idealistic formulation in the contract according to which the PAC shall be granted “only once the Contractor shall have demonstrated to the Owner’s satisfaction that the Plant design and construction complies with all such laws and regulations”. Formulated in such a way, this condition toward obtaining the PAC creates confusion. It raises questions as to the proof of its fulfilment: technically speaking, to meet this PAC requirement, the Contractor would have to list in an exhaustive manner all the laws and regulations potentially applicable to the project and justify, for each of them, in what way the Plant is in compliance. Such an approach is unrealistic and creates a potential for abuse when evaluating whether the condition has been met. In such instances, it shall be the lawyer’s role to understand what the parties are exactly after and suggest a drafting solution which, on the one hand, will be reasonable for the Contractor in terms of the practicality of proof and, on the other hand, will give the Owner the necessary assurances. Taking the same example of the compliance with laws and regulations, a more neutral and balanced formulation would be to state that the Contractor shall deliver to the Owner a statement confirming that the Plant is in compliance with applicable laws and regulations. This does not create any unrealistic burden of proof on the Contractor and, for the Owner, it allows clear recourses against the Contractor should it turn out subsequently, i.e. during the warranty period, that a non-compliance has been identified

Another example is the famous punch-list issue. When efficiently designed, the punch-list is a mechanism allowing a taking-over of the Plant in spite of certain deficiencies if they are only of a minor nature. The rationale here is that while major defects can be a ground for the Owner to refuse to grant the PAC, minor deficiencies should not be a reason to abusively delay the taking-over of the Plant. In connection with the drafting and negotiation of the punch-list mechanism in the contract, the lawyer should carry out the necessary detective work in order to understand from the engineers and project managers what should constitute minor deficiencies going into the punch-list, and what should constitute major defects justifying a refusal to grant the PAC

certain standard conditions required to obtain the PAC will be easier to approach in a neutral and balanced manner than others

1. **Applying the taking-over clause**

The lawyer’s role is not limited to the drafting and negotiation of the taking-over clause. Once the construction contract is signed and the conditions precedent to commencement of the works are fulfilled, the lawyer shall remain active in providing legal support to the project team. In connection with securing the taking-over of the Plant, we will review the lawyer’s input in following the steps toward PAC achievement (1) and, when doing so, in getting the project records straight (2).

1. Following the steps toward PAC achievement

Each corporation is organized differently, but two main trends can be identified in terms of lawyers’ involvement in such matters. Some corporations fully distinguish between tendering teams and project execution teams

This approach avoids finger pointing and, in addition, allows the project team to have an excellent understanding of the contractual basis since they have accompanied the contract formation throughout the tendering stage.

During this early phase in the project execution, the lawyer’s input will be quite helpful in i) explaining to the project team the general terms and conditions of the contract and ii) highlighting whatever legal or contractual particularities are applicable, especially those relevant for the taking-over process.

the lawyer should not hesitate to draw attention to peculiar provisions of the law governing the contract that can seriously affect some aspects of the taking-over phase.

2. Getting the project records straight and ready for PAC achievement

Beyond the input with respect to providing the project team with contractual awareness and legal understanding of the various aspects influencing the taking-over phase, the lawyer should meet the needs for an adequate level of legal support on the contract management side.

In addition, in smaller corporations involved in construction projects as major subcontractors or consortium partners, the project team may not necessarily include a full time contract manager and, in such cases, the project director may rely on the in-house legal department or the outside legal counsel to follow-up contract management issues during the project execution. This is what our German colleagues refer to as “*baubegleitende Rechtsberatung*”, i.e. legal advice “accompanying” the construction project.

Nevertheless, a classical approach to ensure proper project track records and a sufficient level of formality will be for the lawyer to be consulted on:

* the drafting of variation orders or other amendments to the contract that may have an impact on the fulfillment of the conditions for obtaining PAC

It is important on such critical aspects for the project team to review jointly with the help of their lawyer the list of contractual points to be addressed in such an amendment.

* the drafting of formal notices to the other party.

it will be important to verify with the project lawyer that the formality required for the issuance of a notice of force majeure event under the contract or the governing law

* the review of major correspondence that may be a premise to a contentious situation or require strong legal substantiation.
* the drafting of the taking-over certificate or other similar PAC documentation that may be exchanged between the parties to record the PAC achievement.

In sum, the lawyer’s role extends to the monitoring of the paper trail and the legal aspects of data management with a view to get the records straight and ready for the PAC phase and its achievement. Unfortunately, things do not always run as smoothly as one would expect during project management and execution. It is therefore appropriate to turn now to the input that the lawyer may be able to provide when the obtaining of the PAC is subject to a conflict situation between the parties.

**II) Securing the PAC through problem-solving measures**

There are various reasons that may explain difficulties and frictions between the parties in connection with the achievement of the taking-over of the Plant. The lawyer’s role in such a conflict situation will be to understand the background of the conflict (A) in order to be in a position, together with the project and management team, to propose and implement a way forward to solve such a conflict situation (B).

**A. Understanding the PAC conflict**

In order to fully understand the crisis and its ramifications, it is vital for the lawyer to analyze the source of the delay in obtaining the PAC. The delay can indeed be the result of a default, by one or both parties, in the performance of obligations related to the taking-over phase (1). But it can also find its origin in a lack of clarity of contract provisions leading to a misunderstanding and diverging views between the parties on the fulfilment of the conditions toward obtaining the PAC (2).

1. Defaults of the parties delaying the taking-over of the Plant

In view of the long-term and complex nature of major construction projects many things can go wrong either on the Owner’s side, the Contractor’s side, or both, which can explain a derailment of the project schedule and an ensuing delay in obtaining the PAC

For illustration purposes though, we will outline a few.

On the Owner’s side, it is worth mentioning the lack of operating permits legally entitling the Owner to operate the Plant during the reliability run, a delay in the performance of certain works (e.g. civil works) falling under the scope and control of the Owner, the unavailability of consumables or raw materials to be provided by the Owner to allow the carrying out of the performance tests, a delay in obtaining import licenses for customs clearance, or a delay by the Owner in reviewing and approving technical drawings and other documents required to move to the next phase of the project.

On the Contractor’s side, a delay in fulfilling the conditions toward obtaining the PAC can, for example, be due to the bankruptcy of a key subcontractor, a strike on the construction site, a failure to meet the minimum guaranteed performances, an equipment breakdown requiring remedial works, unusually adverse climatic conditions, or a change in law imposing technical modifications to the equipment while the project is already under execution.

1. Diverging views as to the fulfillment of the taking-over conditions

Apart from situations where a default on the part of the Owner and/or the Contractor leads to a delay in obtaining the PAC, a refusal by the Owner to grant the PAC may also occur as a result of diverging views between the parties on the fulfillment of the taking-over conditions.

This problem will typically find its root cause in a lack of clarity or some ambiguity in the wording of the contract provisions relating to the taking-over phase, including the applicable technical exhibits.

* in the middle of a 30-day reliability run required in the contract to demonstrate that the Plant meets the technical specifications and is therefore ready to be taken over, a force majeure event interrupts the trial run for five days. The force majeure clause of the contract specifies, as is often the case, that a party affected by a force majeure event shall be excused from performance during such event and shall be entitled to a time extension. But how is the force majeure clause to interpret in connection with the reliability run interruption? While the parties may be in agreement on the fact that no breach of contract arises in relation to the 5-day interruption of the reliability run, the Owner may take the stand that the reliability run needs to be recommenced for a 30-day period upon the end of the force majeure event, whereas the Contractor may be of the view that the reliability run will simply need to be resumed where it stopped and should continue only for the additional days required to reach 30 days in total. In such a situation, which can arise if the parties have failed to clearly spell out in the relevant technical exhibits the specific impact of a force majeure event on the reliability run procedure, a clear default by one of the parties is not at the center of the debate. There is only a disagreement as to whether the reliability run conditions are met if the 30-day trial run takes place over a period that included several days of test interruption, hence does not constitute a continuous 30-day trial run.
* Example 2: taking the same 30-day reliability run requirement, the test procedure in the technical exhibits specify that in order to declare the test as successfully completed, the Plant must have released “at least 300 MW output”. The reading of the Plant operational data following the test completion indicates that the Plant produced on average 310 MW over the 30-day reliability run, but was at 280 MW for five days. Here again, a disagreement may then arise between the parties. The Owner considers the test as failed, arguing that the five days at 280 MW indicate that the Plant did not meet the “at least 300 MW output” criteria, whereas the Contractor takes the view that the 310 MW average is the deciding factor to treat the test as successfully completed.

An immediate conclusion to be derived from these examples is that they reinforce our earlier views on the need for lawyers to be involved not only in drafting and negotiating the general terms and conditions of the construction contract, but should also provide some useful insight in the quality control of the technical exhibits.

The other conclusion is that it will be important, when a disagreement occurs between the parties on the achievement of the conditions toward obtaining the PAC, for the lawyer to understand and analyze exactly the origin of the conflict. Are the contract provisions really that ambiguous? Can certain industry standards help resolve the diverging views? Does the contract negotiation phase shed some light as to what the parties may have intended when they discussed the reliability run procedure?

These and other similar questions will need to be raised and investigated by the lawyer with the project team in order to find out, among others, whether there is truly a *bona fide* dispute on ambiguous contract terms or whether one party may possibly be taking an abusive position by exploiting a slight vagueness in the contract terms.

**B. Solving the PAC conflict**

Once the grounds for the conflict around the taking-over phase are fully analyzed and understood, the lawyer can provide input into claim management (1) and the development of a settlement strategy (2).

1. Legal input into claim management

To solve a project crisis situation having arisen in connection with the fulfillment of the conditions to obtain the taking-over of the Plant, a premise will usually be the establishment of solid claims position. The rationale behind this is that none of the parties will seriously consider settlement proposals as a way out of the crisis without grasping the arguments and merits of the other party’s position. Whether on the Owner’s or the Contractor’s side, whether as in-house or outside counsel, the lawyer will need to provide the legal support into the claim management approach.

In the worst case, the parties will not only remain unconvinced about the soundness of the claims position presented, but a set of counterclaims will have arisen in response to the original claim.

While the lawyer advising on the legal aspects of claim management will systematically focus on the contractual provisions as the primary base to substantiate the merits of the stand taken in the dispute, recourse to pertinent statutory provisions should not be neglected.

In this regard, it is interesting to note that most model forms of construction contracts do indeed contain provisions providing for a deemed taking-over mechanism, such as article 10.1 of the FIDIC Conditions of Contract for EPC Turnkey Projects (Silver Book), to name just one. Should the contract however be silent on the possibility to claim deemed taking-over, the provisions of the law governing the contract may bring very useful solutions

Under French law, a deemed taking-over principle has been recognized through judge-made law in instances in which the Owner takes possession of the works and indicates through such behavior an unequivocal intent to accept them. In addition, article 1792-6 of the French Civil Code expressly enables a party to seek a judicial declaration of the taking-over of the works when the conditions for this taking-over are met but the Owner, behaving negligently or in bad faith, fails to accept the works and to take possession of them.

1. Legal input into settlement strategies

After the assertion of claims and, if applicable, counterclaims, the conflict should be mature enough for the parties to explore settlement possibilities.

The lawyer’s professional skills should again be solicited with respect to the development of settlement proposals. True, settlement offers and counter-offers will be heavily influenced by commercial factors and will therefore rely, to a large extent, on commercial decisions taking into account sales strategy, customer satisfaction, financial aspects, technical solutions, reputation on the market and the like. The lawyer should nevertheless have a say and give the legal expert views on the rationale for a settlement. Whether e.g. a partial or full waiver of delay or performance liquidated damages, a conditional issuance of the taking-over certificate, some spare parts delivery, a warranty extension, a damage indemnification, a contract price reduction, or similar, can realistically be envisaged within a settlement package are points where the lawyer’s views will be helpful to assess the extent to which the settlement offer is sensible or not.

This is, among others, the solution envisaged in article 35.8 of the MF/1 Conditions, which provides for a contract price reduction mechanism as an alternative to rejection of the works in the event of a failure to pass performance tests. In such a situation, and while the legal view will not necessarily prevail on the extent of the envisaged price reduction, the lawyer may nevertheless be in a position to provide some insight as to how such contractual provisions are typically applied by courts or arbitrators when the parties are unable to agree on a price reduction, which may help with the fine-tuning of the ultimate settlement approach.

A final remark needs to be made concerning the lawyer’s role and input in settlement transactions. Due to the nuisance value and costly impact of full-fledged litigation in major construction projects, there may be a tendency for certain lawyers to estimate the total legal costs of a dispute, including internal management costs, and then throw this amount in the basket of the settlement package along the lines: instead of disbursing this amount in heavy legal costs, we may as well use this amount to settle and put the dispute immediately to a rest.

Conclusion

The foregoing developments have endeavored to outline the multitude of ways through which the lawyer involved in construction projects, both during the tendering stage and the project implementation phase, may play an important role in securing the taking-over of the construction works. In spite of the professional talents, which the lawyer may display, and of all diligent efforts, which the lawyer may deploy together with the project team in the quest to obtain the PAC, prevention may prove insufficient and conflict avoidance on amicable grounds or through some form of alternative dispute resolution may fail. For such heavily contentious situations, recourse to litigation or arbitration will represent the solution of the last chance, but obtaining the PAC through court decision or arbitral award can mean embarking on a long and dry journey. The parties should envisage this course of action only when absolutely convinced that all reasonable settlement possibilities have been fully pursued and exhausted.

Cours 11

1. **Liability for Defects in Construction Contracts - who pays and how much?, Jeremy Glover**

there is a big difference between a construction defect and a nuisance claim such as a squeaking floor or conditions resulting from lack of maintenance or normal wear and tear. Construction defects could range from complex foundation and framing issues, which threaten the structural integrity of buildings, to aesthetic issues such as improperly painted surfaces and deteriorating wood trim around windows and doors.

The courts have recognised that construction defects can be grouped into the following four major categories:

* 1. (i)  Design deficiencies
  2. (ii)  Material deficiencies
  3. (iii)  Specification problems
  4. (iv)  Workmanship deficiencies

The purpose of this paper is twofold:

* 1. (i)  First, to review how a typical English contract treats defects from the viewpoint of the relationship between the employer and contractor;
  2. (ii)  Second, to consider how damages for defects are assessed in other words the cost of reinstatement versus diminution in value.

**Liability for defects under the Contract**

the Standard Building Contract or SBC: consider how the SBC regime deals with defects.

Taking-Over Certificate, for example under clause 10.1(a) of the FIDIC General Conditions, the engineer will:  issue the Taking-Over Certificate to the Contractor, stating the date on which the Works or Section were completed in accordance with the Contract, except for any minor outstanding work and defects which will not substantially affect the use of the Works or Section for their intended purpose (either until or whilst this work is completed and these defects are remedied).

The Rectification Period is akin to a guarantee period and the contractor usually has the obligation, and indeed the right, to remedy defects appearing within this time. The contractor does not get paid for this. However, the practice is to the benefit of both parties since the contractor would otherwise be liable for the greater cost of another contractor remedying the defects.

What should be understood is that a provision for the making good of defects within this period does not deprive the employer of his damages for defects appearing outside that period nor will it serve to extend the time allowed to the contractor to finish the works correctly.

When all defects and shrinkages and other faults have been made good, the architect/contract administrator shall issue a certificate to that effect.

Traditionally, when an employer engages a contractor to construct a building on the basis that the building will be constructed in accordance with an architect’s (or other design professional’s) design supplied by the employer, then in this situation, the contractor, whilst agreeing to carry out the works in accordance with the design documents, makes no promise that the building will fulfil its intended purpose, save in those rare instances where such can be shown objectively to have been the case. Some limited design responsibility may, however, be placed on a contractor. For example, by virtue of the design documents failing to specify all materials, a choice of materials is left to the skill and judgment of the contractor and this is a rich vein for disputes. In addition, by condition 2.17.2.1 of the SBC, the contractor has to comply with statutory requirements.

Thus, where the contract is silent as to some materials to be used in the construction the contractor is still obliged to choose and apply materials in order to carry out the works in accordance with his express undertaking. Such choice is aimed towards the expressly agreed result, that is, the completed building.

With the ordinary lump sum contract (not being design and build) one can usefully consider the question the contractor will often be confronted by, the choice of working methods and temporary works (that is, “how” as opposed to the “what” of construction). The “how” bit in the absence of a specification telling him how to do the works, is for the contractor to decide and the employer will have no duty of guidance or intervention to the contractor.

One issue that is not so straightforward can arise in traditional contracts where the design is not the responsibility of the contractor but that of another, usually the architect, and that is the categorisation of a particular defect. Is it a design defect or a defect of workmanship?

However, a contractor should always take care to consider the implications of the design, even if he thinks he has no design responsibility whatsoever. In some jurisdictions a contractor is under a duty to warn the employer of any problems with the design.

Where a contractor is liable for design, care is required to ensure that the extent of that responsibility is carefully spelt out. In a “design and build” contract, the case law over the years has shown that the contractor, in the absence of an express contractual rebuttal, will be under an obligation to ensure that the finished product will be (reasonably) “fit for its intended purpose”. Sometimes, the design obligation can be found in more traditional contracts, where the contractor might not be expecting any design obligation.

To take clause 4.1 of the new FIDIC form, this states:

*If the Contract specifies that the Contractor shall design any part of the Permanent Works, then unless otherwise stated in the Particular Conditions: ...*

*c) The Contractor shall be responsible for this part and it shall, when the works are completed, be fit for such purposes for which the part is intended as are specified in the Contract;*

Therefore the prudent contractor would be advised to alert the employer to any obvious design defects that he comes across.

…

The obligation to provide works that are fit for their purpose will only be effective if elsewhere in the documentation the purpose has been clearly made known to the contractor. A contractor under such an obligation should ensure that, for example, he has been provided with a general description of any outputs that the employer intends to achieve, or an indication of how the employer expects the plant to perform in a given number of years.

**Damages - who pays and how much?**

As is well known, the basic principle is that awards of damages for breach of contract are intended to put the innocent party in the position they would have been in had the contract been properly performed, so far as money can do this. The purpose of damages is to put the claimant back into the same financial position as he would have been in but for the breach. The purpose of damages is not to punish the defendant but to compensate the claimant.

Essentially, unless the claimant can show that he has suffered a financial loss, he will be entitled only to nominal damages. Where the claimant has suffered financial loss, then money will be able to do this relatively easily. So, for example, the usual measure of damages for defective work or materials is either the diminution in value of the property which results from the defects, or the cost of putting the defects right, subject to considerations of reasonableness and mitigation of loss.

It is rare for a complex construction project to be completed without there being at least some minor breach of the contract requirements concerning the quality and attributes of the finished building. Virtually all construction contracts contain very detailed specifications, drawings and details relating to such matters, and a combination of the complexity of the construction itself and human nature gives ample scope for minor deviations from the contractual specifications.

The normal measure of damages for defective work is the cost of reinstatement taken at the time when the defect was discovered.17 The claimant will not necessarily lose his entitlement to damages if he waits for the outcome of the case before carrying out the remedial works it all depends upon the circumstances of the case.18

Where the law has had difficulties in the past is where there has been a breach of contract but the innocent party claims damages for example, for distress, anxiety, discomfort, inconvenience and loss of amenity which fall outside these two recognised classes of damages.

(p10 stop)

Conclusion:

As I mentioned at the outset, by far the greatest numbers of claims made by employers relate to defects. They will not accept buildings because they are apparently not defect-free. They then pursue actions often many years after the work was carried out. That will continue. It may be that the increasing variety of alternative dispute resolution procedures on offer to the parties, including adjudication, will mean that these disputes can be resolved more easily and economically.

1. **Defining The Difference Between On-demand Bonds And Guarantees, Article by Jeremy Glover**

Bonds, guarantees, performance security or whatever they are called form an important part of every major international contract. Despite this, there are a regular number of cases, in many different jurisdictions, where the courts are asked to decide what the nature of the particular project security actually is. Is the security an on-demand bond or guarantee? An on-demand security bond is an unconditional obligation to pay when a demand has been made. A surety bond or performance guarantee requires certain conditions to be met before payment is made.

**Conclusions**

There continue to be disputes about whether a security document is an on-demand bond, or a guarantee.

**An on-demand bond can be called immediately, and only fraud or very limited challenges have worked in the past (e.g. the bond has expired).**

**A guarantee can only be called upon if a breach of the primary contract has been demonstrated, and the loss has properly crystallised but not been settled by the original contracting party.**

The benefit, therefore, of an on-demand bond is that payment is made immediately, so improving cash flow, and without the need to demonstrate the full and proper loss under the primary contract. There is no need to pursue the original contracting party (who might be insolvent) in order to obtain a judgment or arbitration award.

Nonetheless, guarantees are common in the domestic UK construction market, because they are economic and they are usually readily available from most contractors. On-demand bonds, on the other hand, are much more common internationally, not just because of the nature of the cross-border risks involved, but also because the international contractors operating in those markets are more able to meet their bank's or bondman's requirements of counter-indemnity before issuing an on-demand bond.

1. **Bonds & Guarantees, By Norton Rose**

Bonds and guarantees are often only treated as an afterthought when it comes to risk analysis and negotiation of construction projects. Where used, they tend to be viewed very much as “ancillary” documents to the main construction contract. However this does not do justice to the significant role that these instruments may in fact play if something goes wrong with a project.

The current inclement economic climate has led to an increase in the failure rate of construction projects and insolvency of parties to construction projects. In turn bonds and guarantees are coming under greater scrutiny as employers and contractors alike become ever more anxious about their exposure to risk. There has been a marked increase in the number of cases in which we have seen employers call, or threaten to call, performance bonds in recent times.

As a result, it is essential that parties to construction contracts are familiar with the characteristics of bonds and guarantees, the differences between them and considering where it may be appropriate to use, or resist the use, of each.

**Fundamental features of bonds and guarantees**

Although in practice the words “bond” and “guarantee” are often used interchangeably, under English law they have particular meanings.

***What is a bond?*** A bond is usually contained in a document given by a third party in support of the obligations of another party, containing a promise to pay money immediately or on a future date. It thereby provides an assurance to the beneficiary that the contracting party will perform its obligations, and security if it does not.

Performance bonds are most likely to be called in the event of a contractor going insolvent or (less frequently) in the event of a dispute between the employer and the contractor. The obligation to pay money is commonly capped at 10% of the contract sum until completion of the works and then at 5% until the rectification of defects notified in the warranty period is complete. These sums and periods are, however, a matter of negotiation.

***Who issues bonds?***

Bonds are normally issued by banks, insurance companies or specialist surety companies. Collectively these are known as bondsmen.

Bondsmen will invariably seek a counter-indemnity from the party requesting the bond (i.e. the contractor). In the case of a bank bond, this would normally be secured against the contractor’s overdraft facility.

***Conditional bonds***

Conditional bonds are sometimes referred to as “default” or “proven default" bonds and are predicated on a breach of the underlying contract by the contractor. They are conditional in the sense that there has to be sufficient proof by the employer of the default of the contractor and of damage having been suffered by the employer before the bondsman is obliged to make any payment under the bond. Usually, the bond will be structured such that the bondsman will only be obliged to make payment where there has been a default under the contract and the claim is either agreed (between contractor and employer) or the employer proves its claim in formal dispute resolution proceedings. Bonds can also be made conditional on an adjudicator’s decision or on an expert’s determination. If the decision or determination is not final and binding on the parties, the bond will need to include a mechanism to account for any overpayment or underpayment once the dispute has been finally resolved.

For the beneficiary of a conditional bond it is important that the bond must be drafted so that the beneficiary is able to call on the bond in the event of the contractor’s insolvency. The case of *Perar BV v General Surety and Guarantee Company Limited* (1994) CILL 935 CA illustrates the problem. The court in the *Perar* case held that the automatic determination of the employment of the contractor upon its insolvency did not constitute default for the purposes of the bond. From the employer’s perspective this took away the most common reason for having a bond in the first place, namely the protection it offered in the event that the contractor went insolvent. The case went on to say that a default would only arise if the contractor, following its insolvency, failed to discharge its obligations and pay the employer direct loss and/or damage caused by the determination – most obviously the employer’s loss will be the costs of completing the works assuming the insolvent contractor cannot do so. As this would only be ascertained much later on there is a danger that the bond may have expired by that date.

The *Perar* case was not surprising in the sense that under English law it has for some time been established that insolvency is not *per se* a breach of contract. It confirmed that that principle is just as applicable to bonds as it is to other contracts.

As a result, it is therefore absolutely imperative that beneficiaries of bonds include wording clarifying that the insolvency of the contractor and/or the automatic determination of the employment of the contractor for insolvency constitutes an event of default for the purposes of calling the bond.

Key drafting points The following points should be borne in mind when negotiating and entering into conditional bonds:

* 1. Conditional bonds have been held to be guarantees and as such the law of guarantees will apply to them. Accordingly, unless express protective wording is incorporated, any alteration of the underlying contract could potentially release the bondsman.
  2. The bond should make it clear whether multiple calls can be made up to the cap.
  3. Employers will want the widest possible definition of insolvency to be inserted into the underlying construction contract and into the bond.
  4. The bond should have a definite expiry date. The bond should also provide that the beneficiary can claim under the bond in respect of any claims which have been notified to the bondsman on or before the expiry date but which have not been determined by the expiry date.

***On-demand bonds***

On-demand bonds are commonly used in international project finance. They are usually given by banks rather than insurance companies.

The fundamental difference between an on-demand bond and a conditional bond is that an on- demand bond is expressed such that a particular sum of money will be paid by the bank “on demand”, without further conditions.

Subject to what is said below the approach English law takes to on-demand bonds is that they have the effect that their wording suggests. Most importantly, therefore, English law will not look to impose conditions on the beneficiary which the bond itself does not impose.

The effect of giving an on-demand bond has therefore been construed by the English courts as being equivalent to a letter of credit (*Edward Owen Engineering v Barclays Bank International Limited* [1978] 1AII E.R. 976).

The courts will not, in the absence of fraud, grant injunctive relief to prevent an on-demand bond being called.

An on-demand bond puts the bondsman under a primary obligation and as such is independent of the underlying contract. In the *Edward Owen* case Lord Denning stated that *"... [T]he bank must pay according to its guarantee, on demand, if so stipulated, without proof or conditions"*.

Although a bondsman is *prima facie* obliged to pay out on any demand under an on-demand bond, the contractor could seek to obtain injunctive relief from the courts against payment being made on the following grounds:

* 1. where the bond is not truly unconditional, on its proper construction. Simply calling a bond an “on-demand” bond will not be decisive, and the actual terms of the bond will need to be considered carefully. In *Trafalgar House Construction (Regions) Limited v General Surety and Guarantee Company Limited* [1995] 3 All ER, the deed was described as a bond but was held to be a guarantee;
  2. where the written demand required by the terms of the bond is deficient. Even if a successful challenge is made on these grounds, it is likely to only be a delaying tactic until a proper demand is made; and
  3. fraud. A contractor may successfully obtain relief if there is fraud on the part of the beneficiary. In the context of a performance bond, fraud has been defined as the beneficiary making a claim for payment to which the beneficiary knew it was not entitled. However, where such an injunction is sought against a bank, restraining the bank from making payment under the bond, the burden of proof is high. The facts must be such that the only realistic inference to draw from the evidence is one of fraud, which must be clear, both as to the fact of fraud and as to the bank’s knowledge.

Where an employer makes a call under an on-demand performance bond and it is subsequently found that its demand exceeded the amount to which it was entitled, it is generally accepted (unless it is expressly stated to the contrary) that the employer is obliged to account for the excess.

**The different types of bonds**

***Performance bonds***

Performance bonds are designed to ensure that the contractor delivers goods or performs services in accordance with the terms of the contract. If the contractor fails to perform the contract, it is likely that the employer will suffer a loss, usually because of delay or because the buyer is obliged to pay a higher price to acquire the goods or services elsewhere.

The bondsman thus undertakes to pay to the employer a sum of money if the contractor fails to perform the contract. The bondsman does not undertake to deliver the goods or perform the services itself. The counter-indemnity from the contractor in favour of the bondsman, and the contractor’s own primary obligation, are designed to ensure that the contractor does his utmost to perform the contract.

***Advance payment bonds***

Advance payment bonds manage the risk of the contractor’s failure to earn the whole of any advance payment from the employer by failing to provide goods and services to an equivalent value. The failure may result from the contractor’s insolvency, fraud or default through using the advance payment for another purpose.

Such bonds usually contain a reduction clause, whereby the amount of the bond reduces in accordance with monthly certificates until the certified value of work done exceeds the advance payment.

***Retention bonds***

Retention bonds cover the risk of the contractor’s failure to perform the contract. Retention monies are normally viewed as a security for the cost of rectifying defective works. Early release of retention monies (the attraction to the contractor being to obtain early release of retentions to help cashflow), can be secured by a bond providing the employer with added security from the bondsman in the event of the contractor’s default in carrying out defective works.

***Off-site materials bond***

Off-site material bonds cover an employer against the risk of paying the contractor for materials being manufactured off-site. If the contractor or sub-contractor becomes insolvent, the employer can claim on the bond for the amount of the goods it has paid for in the event that the goods it has paid for are not delivered to site.

***Bid bonds***

Bid bonds are used to compensate an employer if a contract has to be re-awarded because a prospective contractor refuses to enter into the contract after his tender is accepted. Because the form of contract is likely to be unclear or at least not to have been entered into at that stage, a conditional bond is unlikely to be appropriate.

***Adjudication bonds***

Adjudication bonds are conditional bonds which require the bondsman to pay out on an adjudicator’s decision. These are now the norm in UK PFI/PPP projects. As adjudication is now becoming more and more common internationally, it may well be that adjudication bonds will become more common for those outside of the UK in due course.

However, the outcome of an adjudication may only be an interim position. Unless the contract provides that the adjudicator’s decision is final and binding, it may be varied by subsequent arbitration or litigation. An adjudication bond is unlikely to be appropriate in these circumstances. Such a bond would need to cover a mechanism for balancing payments when the dispute is finally determined, which could make it a complex document.

In *A Straume (UK) Ltd v Bradlor Developments Ltd* [2000] BCC 333, it was held that under the English insolvency law, the employer would need the leave of the court to commence/continue with adjudication where the contractor was in administration.

**Guarantees**

What is a guarantee?

A guarantee is given by a third party (a guarantor) to provide an undertaking to a beneficiary that the guarantor will answer for the debt or default of a third person (the principal debtor). The principal debtor remains primarily responsible for payment or performance of the relevant obligation. Guarantees are often provided by parent companies where a party is contracting with a subsidiary without substance.

Guarantees can be either performance guarantees or financial guarantees. Under a performance guarantee, the guarantor will fulfil all of the obligations of the contractor under the construction contract. Under a financial guarantee, the guarantor will compensate the beneficiary for the loss it suffers as a result of the principal debtor’s default.

***Formalities***

Guarantees must be in writing and signed by the guarantor. Unless executed as a deed, there must be consideration. The guarantor must have the necessary capacity to give the guarantee, otherwise the guarantee will be void.

***Duration of the guarantee***

The guarantee backs up contractual duties and, as such, the employer will push for it to last as long as the liabilities of the actual contracting parties under the contract. This will include the limitation period within which to bring claims for poor performance of the underlying contract. Under English law, the majority of construction contracts are entered into by way of a deed. Unless the contract provides otherwise, this will mean that the applicable limitation period is twelve years from the date of breach. However, it is common for this period to be limited by agreement, particularly in relation to defective works. Often, however, a distinction is drawn between patent and latent defects.

However, parent companies should attempt to limit their liability and push for guarantees that expire upon the certification of making good defects or upon notice of practical completion.

***Discharge of guarantee***

A guarantor's obligations are the same as the contractor's obligations under the underlying contract. As a result, the guarantor will be released automatically if there is a material variation or alteration in the terms of the underlying contract without the guarantor's consent (*Holme v Brunskill* [1878] 3 QBD 495).

Consequently, an employer will attempt to ensure that the guarantee includes wording to the effect that the guarantee is *not* discharged or released by any alteration to the nature or extent of the works, any allowance for time, forbearance, indulgence or other concession granted to the contractor under the guaranteed building contract.

These clauses are known as protective or saving clauses, and it is usual for them to be included in guarantees.

Enforceability An employer will want the guarantee to state that its right to claim under the guarantee is not subject to an obligation first to seek recourse against the contractor before being able to pursue a remedy under the guarantee. In other words, the employer will want to be able to bring a claim against the guarantor instead of, or alongside, bringing a claim against the contractor itself.

Parent companies will often not want to be dragged into any dispute and so will want to resist this.

***Set off***

Employers will request that the guarantee states that the guarantor will not compete against it to recover sums from the contractor, and waives any rights for set off or counter claim the guarantor may have against the contractor in connection with the guarantee.

Without such a clause the benefit of the guarantee would be undermined where the contractor owes sums both to the employer and the guarantor.

**Are guarantees more attractive than bonds?**

An on-demand bond will often be the employer's preference when considering which security to take out, given the ease of calling on a primary obligation compared with calling on a secondary obligation. Effectively, a sum of money will be set aside when an on demand bond is in place. The disadvantage for beneficiaries of secondary obligations is that the claim still has to be substantiated against the guarantor and, in practice, a claim against the guarantor is resisted just as strongly as any claim against the original party to the contract.

However, the employer’s decision will depend on other factors such as cost, time and commercial bargaining strength. The benefit of guarantees is that often they are given free of charge and, as such, are not an expense which will be added to a contract sum. On-demand bonds can be expensive, and assuming that contractors are willing to meet this cost, they should build this expense into their price.

Contractors should bear in mind the bargaining strength that an on-demand bond will give employers. An employer with an on-demand bond can use the threat of calling in the security at any point (whether it is right or wrong) against the contractor, who will usually have a parallel obligation to the bondsman under his indemnity, if the bond is called. Although such threats have been rare in the past and in the good times, we have seen employers demonstrate far less resistance to calling (or threatening to call) bonds in recent times.

**Conclusions from the case law**

A contractor should be wary of on-demand bonds and the scope for their misuse. Once an on- demand bond has been issued, there is nothing, in the absence of the issuer's knowledge of fraud, to prevent the bond being called. This could have disastrous consequences for the contractor. The contractor should look out for phrases such as "on [first written] demand" or "on demand without proof or conditions", which will mean that the document is truly an on-demand bond. Once it is, English law will give effect to it as written.

The contractor should also consider the cost of an on-demand bond or guarantee. It is likely to be more expensive to provide an on-demand bond or guarantee.

The contractor should consider taking out unfair calling insurance to guard against the risk of an unwarranted demand, although this may be difficult to obtain.

An on-demand bond has obvious advantages for the employer. It is therefore not surprising that employers will frequently require an on-demand bond. The contractor's ability to resist such a request depends on his negotiating strength, but the following points may assist the contractor:

The employer's main concern is often the insolvency of the contractor.

An on-demand bond is purely a financial instrument where the issuer's prime consideration is the financial strength of the contractor. A surety or insurance company will carry out an underwriting exercise and will carry out an assessment not only of the contractor's financial position, but also the contractor's ability to perform its contractual obligations. If the employer is concerned not only as to the contractor's financial status but also as to the contractor's ability to perform, then the issuer may take more comfort from the issue of a guarantee. However, caution should be exercised because the surety's willingness to provide a bond may result from the nature and extent of the security held by the surety over the principal's assets, rather than solely the ability of the principal to perform.  Claims relating to non-performance should be justified. Any rights which the contractor has, such as outstanding payments, should be taken into account.  An on-demand bond does not necessarily avoid litigation. If the employer suffers damage in excess of the value of the bond he will have to pursue the claim for the excess under the contract. If the contractor disputes the claim he (or his insurers) may pursue the employer (but usually not the bondsman) to recover any excess payment.

An on-demand bond may place additional costs and risks on the contractor which he is obliged to reflect in his pricing.

1. **Bonds & Guarantees, By Fenwick Elliott, Ted Lowery**

Bonds and guarantees are forms of security. The security is provided by a third party so in a typical arrangement, A contracts with B but A also enters into a separate agreement with C to protect itself against any failure by B. This separate agreement requires C to “guarantee” the obligations of B. C will not of course be offering such comfort to A without having covering its position with B, so ordinarily B will be under an obligation to make good any loss suffered by C, should C have to pay A2. So ordinarily we have three sets of interlocking obligations:

* As between A and B: the principal contract
* As between A and C: the bond or guarantee
* As between B and C: the indemnity

**Bond or guarantee:** What these documents should have in common is the underlying objective of providing some assurance as to payment (or fulfilment of obligations) from a solvent (or expected to be solvent) third party.

In particular it will be important to determine whether or not the document includes primary or secondary obligations.

The main (and significant) difference between primary and secondary obligations can be illustrated by reference to the A – B - C arrangement outlined in paragraph 3 above:

* If C assumes a primary obligation to A then this obligation comprises a stand alone undertaking by C that is not contingent upon any liability being established by A against B4.
* If C assumes a secondary obligation to A then this obligation will be contingent upon a breach by B of the contract with A. If A cannot establish a breach by B then C has no liability.

Thus from C’s point of view, a primary obligation is considerably more onerous and unsurprisingly, many of the disputes over surety contracts that have reached the courts have involved C arguing that its obligation to A was secondary rather than primary.

**Primary obligations**

In construction, the most common example of a primary obligation is that contained in an ‘on demand bond’ under which C is required to pay A the sum demanded without reference to the liability position between A and B. In a true on demand bond you would usually expect to find wording along the following lines:  *“I promise to pay you on receipt of your written request without proof or conditions.”*

An on demand bond is therefore equivalent to a blank cheque and as such, gives the benefitting party – usually the employer - a huge advantage whilst conversely imposing upon the contractor the substantial risk that the employer may abuse its position by making a demand without any due cause.

If the arrangement between A and C is a true on demand bond then the legal position remains that A need only comply with the provisions concerning serving the demand on C in order to get the cash and C may only avoid its obligation to pay if there is clear evidence of fraud. This is a difficult hurdle for anyone seeking to restrain payment - a mere suspicion of fraud will not be enough

A question frequently asked is: “*Can the contractor recover the money paid out under an on demand bond it it was not at fault?*” In theory, the answer to this question is “*Yes*” because an on demand bond will not ordinarily give A an absolute entitlement to the money collected but will simply provide a trouble free mechanism for securing payment. However, the practical reality may be different.

In the typical situation, if A took advantage of on demand bond and obtained from C a large payment without any actual entitlement, C would recover this sum from B relying upon B’s indemnity. B therefore would be out of pocket despite having done nothing wrong.

The proper course of action for B would therefore be to follow the contractual dispute procedures and seek to establish that there was no default. Ultimately, if B could establish that it was not in default it would expect a Court of Tribunal to order A to return the money or at least give some credit for this money.

However, this course of action may not represent a realistic or practical solution for B. At best, the contractual dispute procedures will be long winded and expensive and at worst may amount to a waste of time if A is an entity in a foreign state where claims enforcement is difficult or if A has become insolvent during the intervening period.

The use of on demand bonds is common in international projects – where the prospects for recovery of money due may be poor – but rather unusual in UK based construction work. However, we sometimes see on demand bonds in the form of retention bonds and advance payment bonds being provided in relation to large UK projects, for example in the petrochemical and process engineering fields. Generally speaking: A retention bond is usually provided to cover the employer’s costs in the event that the contractor does not attend to specific items of work, maintenance or defects during the DLP.

An advance payment bond is usually issued to cover the sum paid in advance by the employer and is intended to provide the employer with some protection in the event that the advance payment is effectively lost if the contractor becomes insolvent before any works are carried out.

**Secondary obligations**

Secondary obligations are far more common in relation to domestic construction projects in the form of a bond or guarantee that provides security to A, only in the event that as against B, A can establish a default and a sustained loss. The obligation is secondary because it depends for its existence upon a liability arising under the principal contract. In the construction field instruments creating secondary obligations are most frequently described as ‘default bonds’, or ‘performance bonds’. In this paper I shall use the description “conditional bonds” to describe these types of instruments in the sense that C’s secondary obligations will only be triggered on condition that certain prescribed events occur.

Parent company guarantees are a typical example of a secondary obligation - the parent guarantees the performance of the subsidiary but is only required to take action if the subsidiary causes the employer to sustain a loss.

It can immediately be seen that this type of arrangement does not create the significant advantage presented by on demand bonds. The potential for abuse is not there because the payment cannot be released until the breach and the loss have been established which will ordinarily entail some form of due process such as adjudication or arbitration, where B will have a chance to fight its corner.

Insofar as conditional bonds require C to make good the loss sustained by A if B defaults, conditional bonds are a form of guarantee. As such there are a number of legal principles derived from the law of guarantee that are applicable to conditional bonds, including as follows:

A guarantee must be signed and in writing to be enforceable

Co-extensiveness: This principle underpinning guarantees provides that C shall have no greater liability to A than B would have had. This rule obviously acts to the advantage of C who can make use of any defences to claims advanced by A that B could have used. By contrast under a primary obligation the extent of C’s liability to A is dictated solely by the wording of the document.

Variation of the principal contract: One of the basic rules of a guarantee is that any variation in the principal contract can discharge C from liability.

Again, this rule does not apply to on-demand bonds because a contract creating primary obligations operates independently of the principal contract.

In the real world contractual obligations may be revised from time to time. All the more so under construction contracts that will specifically provide for varied works. In order to prevent even de minimus variations from discharging the guarantee obligations, the following wording or similar should usually be present in any conditional bond:  *“The Guarantor shall not be discharged or released by any alteration of any of the terms, conditions and provisions of the Contract or in the extent or nature of the Works and no allowance of time by the Employer under or in respect of the Contract or the Works shall in any way release, reduce or affect the liability of the Guarantor under this Guarantee Bond”*

These provisions are often referred to as ‘indulgence clauses’ but if substantive changes are made to the principal contract that may potentially prejudice the interests of C then the indulgence clause may not be watertight. Where variations are significant it is important to consider the impact they may have on any guarantee whether in the form of a conditional bond or a parent company guarantee.11 It is always therefore advisable to secure C’s consent when contemplating any major changes to the principal contract.

This caution against varying the principal contract reflects the importance of making sure that the surety contract covers the scope of the work intended under the principal contract. Hence it is useful as an aside to consider how conditional bonds may be affected by more modern procurement routes such as framework agreements.

The main advantage of these arrangements is to allow flexibility in that contracts are “called off” as and when the employer wishes during the framework period with the intention that certain aspects of the works are agreed in advance. In setting up this type of arrangement it is important to consider how any guarantee is drafted.

Framework arrangements in the private sector12 do have a tendency to “creep” beyond the scope of what was originally intended at the outset, particularly if the first projects are brought to a successful conclusion. The contractor’s work scope may well extend beyond that guaranteed by any conditional bond and to the extent that this development materially changes the contractor’s obligations, the guarantor may be discharged. Again, you need to pay careful attention to the wording of the framework agreement. Often, they are written so that the contract between the parties for the actual work is a separate contract from the framework agreement itself. Any conditional bond will need to take account of this.

**What can go wrong?**

Primary and secondary obligations : but in practice these are not mutually exclusive. For example the employer may attempt to improve his or her position by attempting to introduce primary obligations into what was supposed tobeasecondaryobligationinstrument. Converselythecontractormayattempt to water down the potentially drastic effect of an on demand bond by introducing pre-conditions to making a demand. The extent to which these efforts succeed will always depend upon the facts of each case and the wording finally obtained, but any uncertainty is likely to give rise to disputed interpretation that may ultimately require a judge to pronounce upon, years and pounds later.

The wording of an on demand bond may require the notice of demand to include copies of warning notices served on the contractor or a simple statement from the architect/engineer that the contractor is in default.

This wording should not detract from the bond being an on-demand bond, as all these provisions do is add to the administrative steps that are required to trigger payment. There is no suggestion that any default on the part of the contractor or loss on the part of the employer needs to be proved.

Conversely, take the position where what is stated to be an on-demand bond includes a provision along the following lines::

*“The Guarantor guarantees to the Employer that in the event of a breach of the Contract by the Contractor the Guarantor shall discharge on demand the damages sustained by the Employer as established and ascertained pursuant to and in accordance with the Building Contract.”*

The words “*sustained*” and “*established and ascertained pursuant to and in accordance with the Building Contract*” all carry with them the suggestion that some proof of loss is required and would in my view be more than enough to deal with any counter–argument that the words “*on demand*” made this an on demand bond conveying primary obligations.

What events are covered by the guarantee? In a conditional bond it will be important to make sure the wording is clear as what amounts to a default.

It is for this reason that a well drafted conditional bond should always make clear that termination in the event of insolvency is a default.

How long does the guarantee last?

Equally it will be important to make clear when the obligations are to come to an end. Some conditional bonds are expressed to be for specific periods and others come to an end at stated times or on a date that may be fixed by reference to the principal contract. If the expiry date is not made clear then this may lead to disputes at a later stage.

Issues to consider when negotiating surety contracts

Those proposing a bond or guarantee should have a draft form of wording available. This should be a useful starting point but the form of wording tabled may be a something used previously – a precedent – that is regarded as being “tried and tested”. Precedent forms are only tried and tested to the extent that they have not been analysed by a Court and found to be wanting. It is entirely possible that a precedent form may have been used previously without those signing it have ever fully understood its effects. It is therefore important to approach precedents with caution.

Some general points ought to be considered on first review of a draft form of wording for a bond or guarantee:

* Does the text include phrases like “on-demand”, “without proof or condition”, “primary obligor” and “indemnity”? (These will obviously point to an intention to impose a primary obligation).
* Is it intended that the guarantee or bond is to be issued by a bank (or by a specific bank) or by a parent company?
* Does the wording mention a fixed or maximum value of the security required?
* Does the wording read like something out of a Dickens novel?
* Is there apparent evidence of amendment of a standard form?

I would say that the priority when being presented with a draft document should be to establish whether or not the employer is looking for security in the form of a primary or secondary obligation. In my view any request for an on demand bond in a domestic context should firmly resisted. If the employer wants an on demand bond, then the employer should be asked to fully justify why it feels the need to have such a potentially drastic security option. At the very least the contractor should counter offer a conditional bond as a reasonable alternative or seek to negotiate down the maximum sum recoverable. (In the *Edward Owen* case the sum covered was for 10% of the contract price). If there is no alternative and you are required to provide an on demand bond then the best you can probably do is to be aware of the potential risk imposed by such an arrangement. (In *Edward Owen* Lord Denning observed that it would make sense for the contractor to regard the amount secured by the on demand bond as being a discount on the price!)

Turning to the small print, as with any other contract the general question to think about when considering the detailed terms and conditions is something like: “*Does the wording clearly describe the obligations of the parties and prescribe the outcomes for all of the relevant eventualities*.” If the employer wants a primary obligation and the contractor is willing to concede this then it is in the interests of both parties to make sure this is clearly expressed so that future disputes may be avoided.

* Thus it is important that the small print is consistently clear (ambiguity leads to arguments) as to the following issues:
  + The nature of the obligation imposed.
  + The period over which the obligation is to be maintained and/or the expiry date.
  + The maximum or aggregate maximum sum payable.
  + The mechanism by which notice of demand is be provided.
  + What amounts to a default?
  + If it is necessary for a loss to be “sustained” and how that sustained loss is to be proved.
  + Those events that will discharge the guarantor’s obligations.
  + How disputes are to be resolved and pursuant to what law (just in case).

1. **DRAFTING AN ENFORCEABLE LIMITATION OF LIABILITY CLAUSE, Poole Professional Ltd. & Wortley/Poole Professional Ltd.**

A limitation of liability (LOL) clause in a contract with a client typically limits the liability of the design firm to some proportion of its fee or a defined dollar value. Numerous court cases have upheld the legality of such clauses.

A landmark court case was decided in California in 1991 when a developer, Markborough California, Inc., sued the consulting engineers who had designed a manmade lake for a housing project. The lake’s liner failed, leading to a $5 million claim against the engineer. The engineer asserted that, as specified in a clause in its contract with the developer, liability was limited to the amount of its fee — $67,640. A trial court agreed with the engineer. The developer appealed, claiming the provision was not specifically negotiated and not expressly agreed to. The appellate court upheld the trial court, citing that the letter of transmittal the engineers sent with the proposed contract gave the client a reasonable opportunity to review the agreement and negotiate any element of it. (*Markborough v. Superior Court*, 227 Cal. App. 3d 705 1991.)

Subsequent cases supporting LOL include *Union Oil Company of California v. John Brown E&C, Valhal Corp. v. Sullivan Associates, Inc.,* and *R1 Associates, Inc., v. Goldberg-Zoino & Associates, Inc.* However, there are also cases where courts have overturned limitation of liability provisions.

So how do you maximize the chances of your LOL clause being enforced if challenged? Generally, if the LOL clause is entered into between parties of relatively equal bargaining strength and is reasonable and clearly drafted, it will be enforceable — unless there is a state law to the contrary or it is determined that the enforcement of the limitation would be unconscionable. Courts will also examine the language of the LOL clause to determine whether the problem that created the liability is covered by the clause.

***Negotiate the LOL Clause***

An important factor in enforcing an LOL provision is to be able to show that the provision was negotiated between two parties with relatively equal bargaining power. Your success in negotiating an LOL clause with your client depends on several factors. Your first step should be to initiate a frank discussion of risk allocation concepts.

you may want to highlight the LOL clause in some manner. Some attorneys prefer that the clause be printed in bold, large type, capital letters, or with space provided for both parties to initial. Others include a paragraph just before the signature line of the agreement that states the contract contains a limitation of liability clause and that the client has read and consents to all terms.

***Establish an Equitable Limit***

As the two cases above demonstrate, courts do not look favorably on LOL clauses that limit liability to a minimal dollar amount. Many attorneys suggest choosing a reasonable fixed amount such as $50,000 or $100,000 as the liability limit. Others set the liability limit at the greater of a fixed amount ($50,000, for example), or the full amount of the design firm’s fee.

***Sample Language***

Standard form contracts — such as those published by the AIA or EJCDC — have developed limitation of liability clauses that are coordinated with the rest of their contracts.

***In Summary***

Limitation of liability may not be attainable in every one of your contracts, but attempting to negotiate such clauses for all of your projects is a worthy goal. And even if the clause is refused, you have started the “risk versus reward” education process for you and your client. Remember that no firm ever got limitation of liability without asking for it.

1. **LIMITATION OF LIABILITY, Michael Clark**

Limitations of liability attempt to limit, define or eliminate damages occasioned by a parties conduct or breach of contract:

* Waiver of Consequential Damages
* Liquidated Damages
* No Damages for Delays
* Exculpatory Provisions Expressly Limiting Liability
* Indemnification Provisions

In general, to be enforceable all Limitations of Liability need to be clear and unambiguous

A liquidated damage provision operates to quantify the damages one party would owe the other upon the occurrence of a specified event.

1. **Exclusion and limitation clausesOut-Law.com**

A construction contract will generally set out the relationship between two or more parties, each party's obligations towards the other and what remedies are available if one party does not meet those obligations. However, in the majority of circumstances the law creates other remedies that will be available to the parties regardless of what is provided in the contract.

In order to create certainty, the parties may wish to limit the scope of what each can claim for. They can do so by using a clause – often called an *'exemption clause*' which limits each party's liability to that which is set out in the contract.

There are various ways of limiting liability in a contract. These include:

* + listing certain types of loss that a party will not be liable for,
  + stating that the contract contains the whole of the parties' agreement;
  + setting a limit on the amount of damages a party will be liable for;
  + excluding certain remedies that would otherwise be available to the party that is not in breach.

**Incorporation and construction**

An exclusion clause must be clearly shown to be incorporated into the contract using clear, unambiguous language. If there is any doubt or ambiguity in the clause, then the clause will be interpreted against the party relying on it – that is, the party seeking to limit its liability. This is known as the **'contra proferentem'** principle.

A case in 2010 involving British Gas showed how carefully exemption clauses have to be drafted if they are to be effective. British Gas, trading as Centrica, hired consultancy firm Accenture to design, supply, install and maintain a new billing system. There were considerable errors and delays in the implementation of this system. In March 2006 the parties entered into an amended agreement to release an amended billing system, but by June of that year a considerable number of errors had emerged which resulted in increased numbers of customer accounts that were not billed properly and unhappy customers.

In February 2007, Centrica notified Accenture about certain 'fundamental defects' in the billing system, but Accenture refused to take any steps to rectify those errors.

There was a clause in the companies' contract which said that liability for loss of profits and indirect loss were excluded, meaning that neither side would have to pay damages to cover those sort of costs.

Centrica wanted Accenture to pay for losses including the compensation offered to its customers and additional borrowing charges it had taken out and the High Court found that these losses were neither loss of profits nor were they indirect losses. Consequently the losses did not fall within the 'loss of profits' and 'indirect losses' exclusion. This was confirmed by the Court of Appeal. Accenture was therefore liable to pay those losses.

The court said that if Centrica was to be considered to have given up its rights to claim for the damages it did then the language in the contract would have to have specifically outlined these as excluded categories of damages.

**The Unfair Contract Terms Act**

The Unfair Contract Terms Act (UCTA) limits companies' ability to avoid liability in their contracts. UCTA is only concerned with exclusion clauses, and does not examine whether a contract is generally unfair.

An 'exclusion clause' is not fully defined in UCTA, but can include any clause attempting to:

* + restrict or exclude liability;
  + make a liability, or the enforcement of a liability, subject to restrictive conditions;
  + restrict the rights and remedies of the wronged party; or
  + restrict rules of evidence or procedure.

Exclusion clauses that are subject to these provisions will either be void in all cases, or void where they fail a test of 'reasonableness'. UCTA does not apply to international supply contracts.

An exclusion clause can never exclude remedies for:

* + death or personal injury;
  + breach of statutory implied terms in consumer contracts.

Different provisions of UCTA apply depending on which type of exemption clause is used and on whether the other party is a consumer or another business. Many construction contracts are concluded between two business entities. In these cases, under English law a party's attempts to limit liability will usually be subject to a test of reasonableness – that is, they will be found by a court to be void if the court considers that they are unreasonable.

For example, a clause purporting to limit or exclude a party's liability for negligence – other than negligence which causes personal injury or death, which cannot be limited in any way – will only be effective if it is reasonable. A clause purporting to limit or exclude a party's liability for breach of contract will be subject to the reasonableness test if the other party is a consumer or if the other party is a business and the parties have contracted on one of the parties' written standard terms and conditions. If both parties are businesses and have not contracted on either's standard written terms and conditions then clauses limiting or excluding liability for breach of contract are not subject to the reasonableness test.

**Entire agreement clauses**

An entire agreement clause is a special type of exclusion clause. It states that the entirety of the agreement between the parties is set out in the contract and limits the liabilities of the parties to a contract to only what is covered under that contract.

An entire agreement clause cannot exclude fraud, such as fraudulent statements made during pre-contractual negotiations.

The elements that an entire agreement clause needs in order to be effective are:

* + a statement that the contract comprises the entire agreement between the parties, and that the contract supersedes any agreements that were made previously;
  + a statement that the parties have not relied on any representation not set out in the contract;
  + an acceptance that the only remedy available to the parties is breach of contract, or any other remedies set out in the contract.

**Exclusive remedies clauses**

An exclusive remedies clause ensures that a party's remedy for any breach of contract is restricted to the remedies set out in the contract, and excludes all common law and other remedies. Exclusive remedies greatly reduce the scope for claims in relation to the contract which means they can be very useful, particularly if you are likely to be the paying party.

Tort is one of the remedies which would be available to a wronged party outside of a contract if an exclusive remedies clause is not used. A claim for damages in tort may be available to a party who has been wronged but who cannot claim a remedy under contract law, whether this is because there is no contractual remedy available or because there was no contract in the first place.

The same requirements apply to exclusive remedies clauses as apply to any other type of exclusion clause, including the 'reasonableness' test under UCTA above.

It is important to check that any exclusive remedies provisions in the main contract are properly mirrored in any subcontract. If not, the contractor will bear the risk of any gaps.

**Liquidated damages**

Liquidated damages (LDs) are damages, fixed in advance, which are built into certain construction contracts. The effect of an LDs clause is that it prevents the wronged party from claiming general damages under a contract, effectively operating as an exclusive remedy. In this sense, an LD clause acts as an exclusive remedies clause.

For more information about LD clauses, please see our [separate OUT-LAW Guide](http://www.out-law.com/en/topics/projects--construction/construction-contracts/liquidated-damages/). Briefly, however, in order to be enforceable an LD clause must be a genuine pre-estimate of any loss likely to be sustained, rather than a penalty designed to deter a party from breaching the contract in the first place.

If an LD clause is regarded as being a penalty or is too vague to be enforced, general damages may still be available as a fallback.

**Drafting issues**

In order to avoid being caught out, here are some of the issues you should consider when drafting or negotiating an exclusion clause:

* + identify your commercial concerns – what sort of losses will be most significant to your business? Which losses will you want to recover?
  + identify what types of loss should be excluded. It is standard practice to limit to employer's losses, but there may be a reason to also limit the contractor's losses such as loss of profit if part of the works contracted for is subsequently not needed;
  + clear and unambiguous wording is essential. Widely drafted working, such as exclusion of 'indirect or consequential' losses, may not exclude loss of profit or revenue if the court considers this to be a 'direct' loss which was in contemplation of the parties when they entered into the contract. Whether a loss is 'direct' or 'consequential' can only be decided on a case-specific basis;
  + decide whether any claim for loss should be subject to notice provisions, and whether a claim will be enforceable if proper notice is not given;
  + decide whether there should be a cap on any losses, and if so whether it should be for losses over a fixed period or over the whole duration of the contract. Consider whether the cap should be different for different types of loss;
  + bear in mind that certain liabilities cannot be excluded – usually liability for fraud, negligently caused death or personal injury. If these are excluded, any such clause may be void;
  + look at the effect of the exclusion clause in relation to any insurance arrangements. Uninsured and insured losses may require different treatment; ensure that any limitation provisions are reflected in subcontract.

Cours 12

1. COORDINATION OF AGREEMENTS IN CONSTRUCTION PROJECTS - Use of the "back to back" principle, Torgeir Myrstad and Marie Braadland

*In almost all construction projects, the contractor enters into agreements with subcontractors, such as electricians, painters, plumbers etc. In lager projects, the use of subcontractors can be quite extensive, and relate to almost every aspect of the construction process. It is in such cases it is not unusual that also the subcontractors enters into agreements with other suppliers in order to be able to fulfill their own contractual obligations. This article focuses on the need for coordination of the agreements on the various levels of a construction project, and the so-called* ***"back to back" principle*** *as a remedy for obtaining this. The intention is to point out both advantages and risks by employing this technique.*

**The need for coordination of agreements**

Even though use of subcontractors is necessary in most construction projects, the complex contract material on different levels may result in extensive and costly consequences for the parties involved. Situations may occur where for instance the contractor must pay liquidated damages to the employer for delays, without being able to pass the costs on to the responsible sub-contractor, or typically, that the contractor's own right to notice of default towards the subcontractor is lost, while the employer has got his right towards the contractor intact. It is therefore imperative that both the contractor and the employer are aware of any critical provisions, and ensure the coordination of these.

Most important for all involved parties, is that the contractual work is performed as painlessly as possible, avoiding burdens which may interfere with the profits that one wishes to obtain from the project. To achieve this, the back to back principle is often used. As this article will show, this is not without challenges.

**What is the back to back principle**

Back to back is often referred to as a clear and unambiguous principle, but this is not necessarily always the case. The principle is often described as a method where the terms of agreement in one step of the contractual pyramid is made a part of the agreement between the parties in the lower steps. In this way one may protect oneself from i.a. critical provisions being left out in a subcontractor agreement, or entering into an agreement which differs from the main agreement due to inaccurate formulations. There are several variants of back to back, of which the two main variants will be described below: Back to back at provision level, and back-to-back at consequence level. In the following we will give an account of what this entails.

**Back to back at provision level - content and challenges**

Back to back on the provision level is characterized by the implementation of almost the exact provisions and wording of the main agreement into the subcontractor agreement. A typical situation would be that the contractor's agreement with the employer is made a part of the parties' agreement at all levels.

An exact copy of the main agreement would still in most cases be unpractical, and it may result in very unfortunate consequences. In any case, certain conditions must be examined thoroughly by the parties. These will be commented upon in the following.

**1) Scope of work**

If the said method is chosen, a minimum requirement is that the scope of work for the individual participant is agreed separately. This will rarely be regulated by the main agreement, while it naturally constitutes an important condition for an unproblematic working relationship.

**2) Time limits**

A situation which also needs special attention in relation to direct use of the main agreement, is the adaptation of the time limits provisions stated in the main agreement to the subcontract agreement. As stated above, it will e.g. become critical for the contractor if he cannot claim performance from the subcontractor by a deadline which may entail liquidated damages for himself. Also the provisions on notice of default will require a thorough review.

If the main contract contains more approximate deadlines like "without ungrounded delay", "within reasonable time" etc., like e.g. the Norwegian building and civil engineering contract, NS 8405, article 20.5, the parties are often given the necessary free scope. If, however, more specified deadlines have been fixed, there is every reason to be especially attentive. The contractor must protect himself by allowing the subcontractor a shorter period for delivery than he himself has been allowed - and the subcontractor must necessarily in turn allow his subcontractor an even shorter period.

**3) Rights and obligations towards the employer**

It is important that the subcontractor's rights and obligations are in accordance with the contractor's liability to the employer. The subcontractor and the employer have no contractual relationship, and the contractor should therefore be sure to impose on his subcontractor the same obligations that has been imposed on himself.

**Back to back at consequence level**

By way of a more consequence oriented use of back to back, provisions entailing the same disadvantages and advantages to the subcontractor as those referring to the contractor are included in the subcontract agreement.

**The reason for such consequence oriented regulation is that the contractor wishes to protect himself against any risks which may occur in connection with the subcontract. The subcontractor may e.g. inflict losses on other subcontractors or other third parties. In addition it is important that all obligations assumed by the contractor towards the employer, is passed down the hierarchy.** Should a kind of guarantee for work delivered have been agreed, it is important that this is included also in the contractual terms of the subcontract agreement, ensuring that the contractor will not risk an obligation to perform the guarantee work himself.

In short the contract technique implies that the subcontractor is obliged to contribute to the contractor's full performance towards the employer. Provisions on strict and unlimited liability may also be included in order to cover possible liability on the supplier's hand.

Examples of provisions to be included could be "*The sub-contractor is entitled to have additional expenses covered only to the extent that the contractor has such expenses covered by the employer" or "The subcontractor's period allowed for notice of default shall be corresponding to the contractor's period allowed for notice of default to the employer*".

Such regulations bear a risk for the subcontractor. Even if costly or delaying modification work which is not caused by the subcontractor in question should occur, he may risk not receiving settlement or not having the deadline extended. One way of preventing such consequences will of course be to ensure that special provisions on the subcontractors' role in this project are included. This would enable the subcontractor to secure covering of his expenses in case the costs of this project should be increased due to circumstances outside his field of responsibility.

When using a consequence oriented back to back solution it is important to realize that the subcontractor will depend on the contractor's following up towards the employer and his loyal following up of claims of extended deadlines or increased remuneration. It is also important that the contractor updates the subcontractor on meetings, rules on interpretation etc. The contractor will in fact be acting as a sort of administrator to the subcontractor. If the contractor fails to follow this up sufficiently, an absolute consequence oriented back to back solution may result in the subcontractor losing his rights towards the contractor. The subcontractor's risk of loss may be reduced by including particular provisions stating explicitly the scope of the contractor's duty of loyalty.

**Back to back regarding individual contractual relationships - summary**

As shown by the above review, the back to back principle contributes to the streamlining of a project. It will, however, be important to be aware of the risks by uncritical use of this technique. In any case prices, scope of work and deadlines must be agreed separately for each case, and in general one should pay special attention to circumstances related to these issues. The back to back principle may well be used at a regulation or consequence level in order to supplement each other or generally to supplement other contractual provisions.

**By way of summing up it could be said that the most important issue for all parties is to be aware of what a back to back regulation may entail in each individual case and to take this into account when estimating the contract price etc.**

1. International Consortia: Deﬁnition, Purpose and The Consortium Agreement, by Joseph Russell Milton

The world press for many years, has made references to contracts being awarded to international consortia, particularly for large infrastructure projects in lesser developed countries. 1 This Article will explore in Part I what an international consortium is, offering a definition which establishes the consortium agreement as the essence of the consortium. Part II explains the reasons for using a consortium in large projects, and Part III offers some practical advice in the formation of a consortium agreement.

A consortium has been defined as "an association of two or more business entities of different nationalities temporarily joined together for the performance of a limited task . . . " and as "an ad hoc or ongoing, informal or formal, sometimes 'shell', association of two or more business/governmental/financial entities to profitably pursue, generally on a competitive basis, one or more common commercial activities .... "

It should be clear that the consortium itself is not an entity, but a contractual relationship between the consortium members.

This relationship is separate and distinct from the form the consortium may adopt. To avoid any definitional confusion between the contractual relationship of the consortium members and the form of the consortium the word "form" should not be included in the definition of a consortium, as in "a form of cooperation between two or more parties for the purpose of meeting a customer's requirements for a specific project.'

the following new and comprehensive definition of a modern international consortium emerges: a temporary contractual relationship of two or more business entities of different nationalities, formed for the purpose of executing, jointly and severally, a specific contract, usually involving complex civil engineering, 7 for the supply of goods and/or services.

consortia will be distinguished from unincorporated associations, partnerships and joint ventures.

It should not be presumed that a consortium is any one of these entities, as the relationship between the consortium members is a contractual one embodied in the consortium agreement. In the absence of any agreement as to form, the duties and liabilities of the consortium members are to be determined by looking at the consortium agreement.

As the relationship between the members of the consortium is purely contractual, there is no a priori intention to adopt the fiduciary impositions of partnership.

A far more important distinction between a consortium and a joint venture is that in a consortium there is no right to share in profits. Each party's profit results from its participation in the consortium. Profit calculations are made without reference to the calculations of other members. The only concern is that other members may take, or fail to take, actions which could endanger expected profits.

Why a consortia ?

A number of reasons have been advanced for the formation of consortia. Often cited is a desire on the part of the consortium members to share the risks of a particular project

Assume that company A can take on the job as a prime contractor, be a member of a consortium, or be a subcontractor to either or both of the other two companies.

If company A is a prime contractor, it will be legally responsible for the total risk of the entire project. By properly drawn subcontracts, however, it may "lay-off" two-thirds of that risk except for those contingencies caused by inevitable gaps in scope of the subcontracts, i.e., the prime contractor will have to supply those items of material or services which are not specifically delineated in the subcontracts.

Part III :

Care should be taken to provide in the consortium agreement for the possible admission or withdrawal of consortium members before, as well as after, the execution of the contract with the customer.

In the event of an admission of a new member to the consortium, unanimity should be required as the original members usually will be jointly and severally liable for the performance of the new member.

These business reasons against the insertion of an anti-tender clause are supported by antitrust considerations, which argue against anything but a qualified restriction on the freedom of the members to bid in competition with the proposal.

A consortium is commonly led, as well as represented in negotiations with the customer, by a Consortium Leader or Chef de File. This position calls for careful definition in the consortium agreement.

The primary function of the Consortium Leader is to coordinate the work between the consortium members, while also serving as an intermediary between the customer and the members. Coordinating the work of members prior to signature of the contracts means reviewing each member's part of the proposal to insure that it is complete, and then reducing all members' parts to a unified, internally logical and consistent whole.

This question of division of work causes more problems in modern consortia, particularly those involving members from different countries, than any other. This is due to an inadequate definition of where one member's scope ends and another's begins.

Vague phrases such as "supply all construction materials," or "provide all equipment needed for," should be avoided in any consortium agreement. Good practice indicates that annexes listing the exact scope of each member, in the maximum degree detail possible, be prepared prior to the conclusion of either the consortium agreement or the final contract with the customer.

The problem of how to manage the project, after the consortium has signed the principal contract, breaks down into two separate questions: (1) how is the project to be managed from the point

of view of overall policy? and (2) how is the day-to-day work in the

field to be directed?

There have been two traditional solutions to the problem.

* One is management by committee;
* The other is delegating all questions of policy and management, except those specifically reserved in the consortium agreement, to one company

Another technique of project management that has proven quite useful in recent years has been that of distinguishing between overall project management and management in the field.

This offers greater efficiency and flexibility in many areas, and is generally most effective in construction projects in lesser developed countries. Under this concept, one company, usually the major equipment manufacturer, is designated Consortium Leader with total responsibility for overall management, including scheduling of equipment deliveries and procurement of any additional services that might be required outside of the country in which the project is to be constructed. Inside the country, another member of the consortium (or an independent company), known as the Field Project Manager, is responsible for management at the site, as well as procurement of all local material and services.

Whatever method of management is used, it should be obvious that the powers of those responsible must be clearly defined in the consortium agreement.kj

The basic liabilities facing a project-oriented consortium are of two types: (1) those for defects in the performance or quality of the project, and (2) those for delay in completion of the project.

The first type of liability is a consequence of "poor performance," i.e., performance which does not meet the contractual guarantees of the equipment supplied. The second type originates in the failure of one or more of the consortium members to meet the commitments of the original schedule.

It would seem natural for the consortium agreement to contain a clause to the effect that the party responsible for the imposition of any liquidated damages is liable for their payment. This, however, ignores two important facts. First, the potential exposure to the consortium may be much greater than any one company normally calculates as its own share of a reasonable contingency for defect or delay in performance. Second, it is often times impossible to assign fault to any single individual member. Therefore, consortium members will seek a formula to determine how liability for fault will be assessed.

Initially, it may seem appropriate to calculate the percentage of liability based on the relative amounts of profit that each of the consortium members anticipates from the job. Experience dictates, however, that many companies are extremely reluctant to disclose profit margins. Also, differences in calculating profits from company to company and from country to country, as well as the desire of each company to insure that such information remains "in house" and not subject to disclosure to competitors, makes the usage of formulas based on profit margins very difficult. The best solution seems to be the so-called "rough justice" approach.

To begin any calculation of interests, exposure to liabilities and the like, the expected gross receipts of each consortium member is used as the basis.

**Financing**

Most large infrastructure projects in the world today require that the companies bidding on such project arrange for some type of long term financing of the project. As long as the bidders are all from one country, this is a relatively simple problem. The problem becomes serious when a consortium of companies from two or more countries seeks to arrange such financing. The various banksinvolved have significant differences as to terms, interest rates, grace periods and formalities.

1. **DESCA model consortium agreement & Guidelines for a Consortium Agreement (CA)**

The CA is an agreement made between participants in a collaborative project to govern a number of issues, i.e. relationship between partners, organisation and implementation of the project, as well as rights and obligations between participants. Partners may not underestimate time needed in the elaboration of such a document, especially if it is the first time. They are encouraged to start thinking about it at the early stages of the project definition. A well prepared CA minimizes the probability of later disputes. The aim of a CA is to remove potential barriers for cooperating on project level and ensuring equitable use of project results.

Therefore:

*  all project partners contribute to, and benefit from, an equitable and balanced cooperation and;
*  results of collaborative projects are shared through a controlled process that protects and equitably allocates any intellectual property rights created or furnished during cooperation.

A draft of the Consortium Agreement is recommended to be in place when the funding negotiations commence; some agencies might require a Consortium Agreement in order to release funds.

The CA needs to be sufficiently detailed in order to show that all will be set‐up to ensure a wellbalanced

cooperation.

1. **Consortium Agreements: A Short FAQ, Andrew Charlesworth and Anna Home**
2. **STANDARD FORMS OF JOINT VENTURE/CONSORTIUM AGRREMENTS AND MEMORANDUM OF UNDERSTANDING PAKISTAN ENGINEERING COUNCIL ISLAMABAD**