

International Comparative Legal Guides



Construction & Engineering Law 2020

A practical cross-border insight into construction and engineering law

Seventh Edition

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Contributing Editors:

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Herbert Smith Freehills LLP

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Preface

Welcome to the seventh edition of *ICLG – Construction & Engineering Law*. As contributing editors, Herbert Smith Freehills LLP are delighted to introduce the latest edition of this comprehensive global guide to construction and engineering law and regulation.

Clearly, 2020 has been a challenging year for the construction sector. Many projects have been delayed and disrupted by the COVID-19 pandemic, and, at the time of writing, it is not clear when some sense of normality will resume. The legal profession needs to ensure that it is in a position to respond to the new challenges that the global construction industry will face in the months and years ahead, both in terms of resolving the issues faced by live projects and ensuring an appropriate allocation of risk in future contracts. There will be no ‘one size fits all’ approach – each project, and each jurisdiction, will have its own challenges to overcome.

As with the previous editions, this guide provides valuable insights into how different legal systems approach the questions that are commonly encountered on construction and engineering projects. It covers 21 jurisdictions, adopting the form of a Q&A. It also includes one general chapter, which looks at the importance of *Force Majeure* clauses in construction contracts.

We are honoured to join a group of distinguished specialists to provide this authoritative guide, and are grateful to all contributors for sharing their knowledge and experience. We hope that you find this guide to be useful, practical and thought-provoking.

Nicholas Downing & David Nitek
Herbert Smith Freehills LLP



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Force Majeure Clauses in Construction Contracts

Herbert Smith Freehills LLP



Nicholas Downing



David Nitek

Introduction

A *Force Majeure* clause is often considered by contracting parties to be a “boiler-plate” clause – included in contracts without much thought or negotiation, and unlikely to be tested in practice. However, the COVID-19 pandemic, which is having a significant impact on construction and infrastructure projects throughout the world, is placing these clauses firmly in the spotlight as parties seek to ascertain the contractual consequences of any delay or disruption caused by the pandemic.

Force Majeure is a civil law concept and has no defined meaning at common law. It is normally used to describe a situation in which a party may cancel or suspend performance of a contract, or obtain an extension of time for performance, following the occurrence of a specified event that is outside that party’s control.

In common law jurisdictions, *Force Majeure* is a creature of contract – it will only arise if the contract includes a *Force Majeure* clause. Without such a clause, the parties may have no contractual mechanism for dealing with exceptional and unanticipated events. As a matter of common law, a contract can be discharged by frustration where supervening events either render performance impossible or transform the parties’ obligations into something radically different than they contemplated. But frustration is both difficult to establish and a blunt tool – it simply brings the contract to an end.

A *Force Majeure* clause has two advantages. First, it creates a regime for regulating events that might otherwise operate to frustrate the contract. Second, it allows the parties to specify the consequences of a *Force Majeure* event, including, for example, extensions of time, additional costs, suspension and termination.

This article will examine:

1. the *Force Majeure* clauses contained in various standard form construction and infrastructure contracts, namely FIDIC, JCT, NEC and LOGIC;
2. the practical considerations that parties should take into account when negotiating *Force Majeure* clauses;
3. the practical considerations that arise when *Force Majeure* clauses are operated; and
4. what happens when there is no *Force Majeure* clause, or if the clause is not wide enough to capture a particular event.

There are two points to emphasise: first, the flexibility of *Force Majeure* provisions, as shown by the many different forms they can take; and second, the profound impact that the drafting can have on how the risk of unforeseen events is allocated between the parties in practice. Therefore, one consequence of the pandemic is that *Force Majeure* provisions may be given more scrutiny going forward than has sometimes been the case to date.

Force Majeure in Standard Form Construction Contracts

FIDIC

The FIDIC contracts include a *Force Majeure* clause (for example, clause 19 of the 1999 FIDIC Red Book). The 2017 FIDIC contracts refer to “Exceptional Events” rather than *Force Majeure* events, but the principles are essentially the same. This article looks at the 1999 FIDIC contracts, which, at least for now, are more widely used.

“*Force Majeure*” is defined at clause 19 of the 1999 FIDIC Red Book as an exceptional event or circumstance:

1. which is beyond a Party’s control;
2. which such Party could not reasonably have provided against before entering into the Contract;
3. which, having arisen, such Party could not reasonably have avoided or overcome; and
4. which is not substantially attributable to the other Party.

Clause 19.1 also sets out a non-exhaustive list of events which may constitute *Force Majeure*, provided that any such event also meets the conditions set out above. These events include: war; hostilities; strike or lockout by persons other than the Contractor’s Personnel; and natural catastrophes such as earthquakes. However, in principle, any event or circumstance can constitute a *Force Majeure* if the general tests are met.

By clause 19.2, the party that is, or will be, prevented from performing its obligations must give notice within 14 days of the date when that party became aware, or should have become aware, of the relevant event or circumstance constituting *Force Majeure*. That notice must specify (i) the event or circumstance constituting *Force Majeure*, and (ii) the obligations which it is, or will be, prevented from performing.

Provided that the Contractor complies with the notice requirement set out above, it will be entitled to an extension of time (although it must mitigate delay) and payment of additional cost. Either party may also terminate the contract, on notice, if the *Force Majeure* event subsists for a continuous period of 84 days or multiple periods totalling 140 days.

JCT

JCT contracts also contain *Force Majeure* provisions, but, in contrast to the FIDIC suite of contracts, *Force Majeure* is not a defined term. For example, JCT Design and Build Contract 2016 lists “*Force Majeure*” as a Relevant Event (i.e., an event entitling the Contractor to an extension of time) at clause 2.26.14.

Given that there is no definition, a tribunal may have regard to case law in which the term “*Force Majeure*” has been considered. For example, in *Lebeaupin v Crispin* ([1920] 2 KB 714) it was said that:

“This term is used with reference to all circumstances independent of the will of man, and which it is not in his power to control ... Thus war, inundations and epidemics are cases of force majeure; it has even been decided that a strike of workmen constitutes a case of force majeure.”

Of note, and in contrast to the FIDIC suite of contracts, there is no entitlement to additional costs as a result of a *Force Majeure* event.

By clause 2.24.1, if it becomes reasonably apparent that the progress of the Works or any Section is being or is likely to be delayed, the Contractor must forthwith give notice to the Employer of the material circumstances, including the cause of the delay, and must identify in the notice the event which, in its opinion, is a Relevant Event (here, the *Force Majeure* event). If practical, the notice should include particulars of the expected effects of the event, including an estimate of the delay to completion. If it is not practicable to provide that information in the initial notice, the Contractor must provide such information, in writing, as soon as possible thereafter.

Subject to complying with the notice requirement set out above, the Contractor will be entitled to an extension of time.

Further, both parties have the right to terminate the contract if the works are suspended as a result of a *Force Majeure* event for a particular period (which is chosen by the parties and specified in the contract particulars).

NEC3 / NEC4

The term *Force Majeure* is not used in the NEC suite of contracts. However, NEC contracts have a concept of prevention events, which are events:

1. that stop the Contractor completing the works or stop the Contractor completing the works by the date shown in the latest programme; and
2. which:
 - a. neither party could prevent; and
 - b. an experienced Contractor would have judged at the Contract Date to have such a small chance of occurring that it would have been unreasonable to have allowed for it.

If a prevention event occurs, the Project Manager is required to give an instruction stating how the event should be dealt with (see clause 19.1).

Pursuant to clause 60.1(19), a prevention event is a compensation event (i.e., an event entitling the Contractor to an extension of time and additional cost). Further, any instruction given by the Project Manager in relation to the prevention event may also be a compensation event (for example, if it results in a change to the works).

The Contractor must notify the Project Manager of an event which it considers is a compensation event and which the Project Manager has not notified to the Contractor (see clause 61.3). If the Contractor does not notify a compensation event within eight weeks of becoming aware of the event, it will not be entitled to an extension of time or additional cost.

Subject to complying with the notification requirement set out above, a prevention event will, in principle, give rise to time and cost relief.

Further, the Employer may terminate the contract if the event either stops the Contractor from completing the works or is forecast to delay completion by more than 13 weeks (see clause 91.7).

LOGIC

The LOGIC forms are used in the UK offshore oil and gas industry. Clause 14 of the General Conditions of Contract for Construction (3rd edition) sets out an exhaustive list of *Force Majeure* events which includes such matters as riot, war, invasion, earthquake, fire, explosion and/or other natural physical disaster, strikes at a national or regional level, and changes to any general or local Statute, Ordinance, Decree or other law.

To obtain relief, the affected party must show that:

1. one of the specific events above has occurred;
2. such event is beyond the control of, and without the fault or negligence of, the affected party;
3. it could not provide against the event by the exercise of reasonable diligence; and
4. it has notified the other party in accordance with clause 14.3.

If the Contractor is delayed by a *Force Majeure* event, clause 14.4 provides that the Contractor is entitled to an extension of time but (similar to the JCT approach) not additional cost.

However, and unlike the other forms of contract referred to above, a *Force Majeure* event does not crystallise an entitlement to terminate the contract even if it subsists for a substantial period of time.

Summary

The forms of contract described above each take a slightly different approach to *Force Majeure*:

1. In FIDIC, JCT and NEC contracts, *Force Majeure* is not defined exhaustively. In LOGIC, by contrast, it is.
2. In FIDIC and NEC, the Contractor is entitled to both an extension of time and additional cost if a *Force Majeure* event occurs. JCT and LOGIC provide that a Contractor will be entitled to an extension of time only.
3. Both FIDIC and JCT allow either the Employer or Contractor to terminate if *Force Majeure* subsists for long enough. In NEC, only the Employer can terminate. In LOGIC, *Force Majeure* does not lead to a termination right for either party.

Practical Considerations

Negotiating Force Majeure Clauses

There are multiple factors to consider when negotiating *Force Majeure* clauses.

Parameters

If the parties intend to include specific thresholds in the *Force Majeure* definition, for example to cover earthquakes of a certain magnitude, any units of measurement should be consistent with those used in any project specifications. Further, it is advisable to ensure that any specific thresholds are measured on an objective basis, thereby reducing the chances of a future dispute.

To take an example: the specification may require a Contractor to design and build a power plant to withstand an earthquake measured on a scale of ground acceleration (which measures the magnitude of the earthquake in an objective manner), but the

Force Majeure clause may measure the earthquake on the Modified Mercalli scale (which measures seismic intensity in a subjective manner). As the magnitude and intensity scales measure two completely different aspects of the earthquake, there may be a disconnect between the project specification requirements and the point at which a party would be able to invoke the *Force Majeure* clause.

Delay

The parties may want to consider whether there should be a minimum period of delay before a *Force Majeure* clause can be invoked. Further, the parties may look to address expressly how to treat any disruption that subsists once the *Force Majeure* event has ended.

Interaction with other contractual provisions

The parties should consider how other provisions of the contract interface with the *Force Majeure* clause. For example, the relationship between the *Force Majeure* clause, the extension of time regime and the liquidated damages provisions should be made clear – if the *Force Majeure* clause simply states that the Contractor is relieved from its obligations, that would not, strictly, move the contractual completion date.

Notice

It should be clear when the notice is to be given. For example, is it when the *Force Majeure* event arises, when it affects the relevant party, or when it actually starts to delay completion? Further, it should be clear if the notice is intended to be a condition precedent to relief (in which case clear drafting to that effect will be needed) and, if so, whether the notifying party loses its entitlement altogether if no notice is given, or just has its entitlement adjusted to reflect the delay in giving notice.

Termination

If *Force Majeure* leads to termination, it would be prudent to specify which party will bear the risk of:

1. any advance payments made for the services;
2. the cost of any materials already delivered to a Contractor, or which the Contractor is contractually liable to accept;
3. the cost of removing any equipment from the site; and
4. the cost of repatriating the Contractor's staff.

PFI contracts

In the context of UK PFI projects, guidance has been issued by HM Treasury on the type of events that should be included as *Force Majeure* events, and this must be taken into account when drafting. The guidance proposes a relatively narrow (and closed) list of events.

Pandemics

If the parties refer to pandemics or epidemics, they should be aware that there is no clear legal definition of the word “epidemic”, and there may be room for debate as to whether a particular disease has passed the threshold. The position taken by an international organisation (e.g., the World Health Organization) will be a good indication of whether there is a pandemic or epidemic, but ultimately each case will fall to be judged on its facts and the particular drafting in question.

How Force Majeure Clauses are Applied in Practice

In practice, the party seeking to rely on the *Force Majeure* clause will bear the burden of proving that the event in question falls within the clause, and that it has caused an inability to perform.

In practice, establishing causation can be challenging, particularly where the inability to perform has competing causes. Whether the *Force Majeure* event must be the sole cause of a party's inability to perform will ultimately depend upon the wording of the clause itself. In *Seadrill Ghana Operations Limited v Tullow Ghana Limited* ([2018] EWHC 1640 (Comm)), Tullow failed to fulfil its obligations under the contract (namely to provide a drilling instruction in October 2016) as a result of two matters, one a *Force Majeure* event and the other not. The *Force Majeure* clause on which Tullow sought to rely stated that: “neither COMPANY nor CONTRACTOR shall be responsible for any failure to fulfil any term or condition of the Contract if and to the extent that fulfilment has been delayed or temporarily prevented by an occurrence, as hereunder defined as FORCE MAJEURE...” The High Court decided that the clause required the *Force Majeure* event to be the effective cause of the failure which, in this case, it was not.

The party relying upon the *Force Majeure* provision will also have a duty to mitigate the effects of the event – even if this is not stated expressly, it is likely to be implied. If it is the failure to take steps to mitigate – as opposed to the event itself – that causes the inability to perform, there may be no entitlement to relief.

Lender Practice

Where a construction project is funded by external financing, the Project Company will need to consider the implications of invoking a *Force Majeure* clause on the Facility Agreement.

For example, the Lender's prior written consent will often be required before the Project Company can claim *Force Majeure* relief or take any steps in response to a *Force Majeure* notice from a Contractor (for example, by accepting that there is a *Force Majeure* event). Otherwise an event of default may arise under the Facility Agreement.

If a *Force Majeure* event occurs which adversely affects the ability of the Project Company to perform its obligations under the Project Agreement, the material adverse effect (MAE) provisions may also be triggered. MAE clauses are used in lending transactions as a catch-all default to enable Lenders to accelerate repayment or refuse to lend additional funds. A MAE clause cannot be triggered on the basis of circumstances known to the relevant party on entering into the agreement, although it may be possible to invoke the clause where conditions worsen in a way that makes them materially different in nature. The change relied upon must also be material, in the sense that it must be sufficiently significant or substantial, and it must not be merely a temporary blip. In any event, there is some legal uncertainty surrounding the issue of invoking MAE provisions, so Lenders often wait until the Project Company defaults under another event of default.

What Happens if There is No Force Majeure Clause

Where the contract does not contain a *Force Majeure* provision, the affected party may seek to rely on the common law doctrine of frustration. Frustration applies where:

1. an event occurs after the contract has been entered into;
2. which is not due to the fault of either party; and
3. which renders further performance impossible or illegal, or makes the parties' obligations radically different from those contemplated when the contract was entered into.

Establishing frustration is far from straightforward, and there are few reported cases where it has been argued successfully (at least in modern times).

The presence of a *Force Majeure* clause in a contract does not automatically exclude the operation of the doctrine of frustration. However, frustration only applies to unforeseen events, and if the parties have addressed a particular event in a *Force Majeure* clause, it could be said that the parties have foreseen that event, such that the party must pursue relief under the *Force Majeure* clause rather than assert frustration.

The effect of frustration at common law is to release the parties from their future obligations and bring the contract to an end. It is therefore somewhat of a blunt instrument, and lacks the clarity and nuance that a properly drafted *Force Majeure* provision provides.

Concluding Thoughts

The COVID-19 pandemic has placed *Force Majeure* provisions firmly in the spotlight. This has served to emphasise the inherent flexibility of such provisions and their importance. Whether the list of *Force Majeure* events is open or closed, and whether a *Force Majeure* event gives rise to an entitlement to cost in addition to relief from performance, can make a significant difference to how the risk of unforeseen events is allocated between the parties. Perhaps, going forward, they will be negotiated more closely than has sometimes been the case to date.



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1 Making Construction Projects

1.1 What are the standard types of construction contract in your jurisdiction? Do you have: (i) any contracts which place both design and construction obligations upon contractors; (ii) any forms of design-only contract; and/or (iii) any arrangement known as management contracting, with one main managing contractor and with the construction work done by a series of package contractors? (*NB* For ease of reference throughout the chapter, we refer to “construction contracts” as an abbreviation for construction and engineering contracts.)

Projects developed in Brazil generally use tailor-made contracts (i.e. contracts specifically drafted for a particular project) rather than standard forms. Nevertheless, contracts based on international standard forms such as FIDIC (*Fédération Internationale des Ingénieurs-Conseils*) and NEC (New Engineering Contract) are being increasingly used whenever a foreign player is involved (e.g. a sponsor, partner or lender). Such projects, however, still represent a small percentage of the projects developed in Brazil.

The most common contractual structures used in Brazil are the following:

Engineering, Procurement and Construction (EPC)

An EPC contract provides for a single point of responsibility. The employer engages a contractor to provide the design, all necessary materials and equipment, and the construction works for the project. In large projects involving construction and erection works, as well as equipment supply (such as power plants and factories), the contractor can be hired to provide its services on a turn-key basis and would therefore be responsible for taking over the project in order to allow the employer to be ready to operate it upon completion of the works by the contractor.

Engineering, Procurement and Construction Management (EPCM)

This type of contract reflects the arrangement known as management contracting, in which the contractor operates as an employer’s agent and enters into separate contracts with different contractors who provide materials, equipment and construction works necessary for the project.

Design-Bid-Build (DBB)

In this type of procurement, the employer engages a designer to provide the basic design of the project. Once such basic design is completed, the project is submitted to a bidding process involving

several contractors. The selected contractor will be responsible for detailing the basic design provided by the employer and, upon the employer’s approval (or by the employer’s technical advisor/engineer), the selected contractor shall perform the construction works in accordance with such detailed design.

Alliance Agreement

By means of the Alliance Agreement, which is a co-operative method of contracting, the parties work together, aligning their commercial interests, to efficiently share the risks and rewards resulting from the contract.

1.2 How prevalent is collaborative contracting (e.g. alliance contracting and partnering) in your jurisdiction? To the extent applicable, what forms of collaborative contracts are commonly used?

Co-operative methods of contracting still represent a small portion of projects developed in Brazil. When used, it is normally under the form of an Alliance Agreement and it is common to establish in such contract the goals to be achieved by the parties in exchange for bonuses, and consequences for underachievement. Although the FAC-1 Alliance Agreement template was launched in Brazil in 2019, it is still too early to say if there will be an increase in collaborative contracting practices.

1.3 What industry standard forms of construction contract are most commonly used in your jurisdiction?

When the parties decide to adopt a standard form for a domestic or international project, they usually use the forms published by FIDIC, including, but not limited to:

- **The Red Book:** conditions of contract for construction for building and engineering works designed by the employer – mostly used in the construction of factories and other specific industrial buildings where the employer is responsible for the equipment of the plant/factory.
- **The Yellow Book:** conditions of contract for plants and design-build for electrical and mechanical plants, and for building and engineering works, designed by the contractor – mostly used in renewable energy projects, especially in wind farms.
- **The Silver Book:** conditions of contract for EPC/turn-key projects – mostly used in mega infrastructure projects.

In addition, the choice of contractual structure depends on various aspects (mainly risk allocation and the sophistication of the parties involved).

The most noteworthy structures used in Brazil are: (i) EPC; (ii) EPCM; and (iii) DBB.

1.4 What (if any) legal requirements are there to create a legally binding contract (e.g. in common law jurisdictions, offer, acceptance, consideration and intention to create legal relations are usually required)? Are there any mandatory law requirements which need to be reflected in a construction contract (e.g. provision for adjudication or any need for the contract to be evidenced in writing)?

In order to create a legally binding contract under Brazilian law: (i) the contracting parties shall have full capacity and authority to contract; (ii) the object of the contract shall be lawful, possible, determined or determinable; and (iii) the formalities required by law, if any, must be observed. Although there is no requirement for the contract to be evidenced in writing, it is highly recommended to do so, in order to provide for balanced consideration and to prevent uncertainties from arising.

1.5 In your jurisdiction please identify whether there is a concept of what is known as a “letter of intent”, in which an employer can give either a legally binding or non-legally binding indication of willingness either to enter into a contract later or to commit itself to meet certain costs to be incurred by the contractor whether or not a full contract is ever concluded.

Letters of intent are often used in construction projects in Brazil. Such instruments can be binding or non-binding, depending on the type of works, project deadlines, risks involved, etc. In most cases, the purpose of the letter of intent is to allow the commencement of certain activities related to the works and even the mobilisation of some contractors’ resources before the detailed design is totally concluded and/or approved. An incomplete binding letter of intent may face enforceability issues in Brazilian courts.

1.6 Are there any statutory or standard types of insurance which it would be commonplace or compulsory to have in place when carrying out construction work? For example, is there employer’s liability insurance for contractors in respect of death and personal injury, or is there a requirement for the contractor to have contractors’ all-risk insurance?

Brazilian rules stipulate mandatory insurance and the most crucial, regarding construction works, are described in Article 20 of Decree-Law No. 73/66 (regulated by Decree No. 61,867/67); namely: (i) civil liability for real estate contractors of urban zone constructions regarding bodily injury and physical damage injuries, and property damages; (ii) assets encumbered as guarantees of loans or financings granted by public financing institutions; (iii) guarantee of compliance with the obligations of the real estate developer and constructor; (iv) guarantee of payment incumbent upon the borrower in relation to construction, including real estate obligations; (v) buildings divided into autonomous units; (vi) fire damage and transportation of goods pertaining to entities located in or transported throughout Brazil; (vii) export credit, whenever deemed convenient by the National Council of Private Insurance (CNSP), taking into account the National Council of Foreign Trade (CONCEX); (viii) bodily injury and physical damage caused by roadway automotive vehicles and vessels – or by their cargo – to individuals, regardless of whether they are being transported or not; and (ix)

civil liability of land, maritime, river and lake transporters for damages caused to the cargo.

It is worth mentioning that although Provisional Presidential Decree No. 904/19 recently revoked the insurance regarding personal damages caused by vessels or by their cargo, its effectiveness was suspended by the Federal Supreme Court. Therefore, such insurance is still mandatory.

In addition to the abovementioned mandatory insurance, there are specific regulations regarding the construction market that also refer to certain insurance coverage, such as: (i) Article 1346 of the Brazilian Civil Code (BCC), which establishes that all buildings must be covered by insurance against fire or total/partial destruction; (ii) Article 13 of Law No. 4,591/64, which establishes that all units of residential buildings shall be insured against fire and other casualties that may cause full/partial destruction of the building; (iii) Articles 1 and 2 of Law No. 4,864/65, which establish that the buyer of a financed real estate building with a maximum value corresponding to 300 times the minimum wage in Brazil must purchase life insurance (*seguro de vida de renda temporária*); and (iv) Paragraph 1 of Section III of Article 56 of Law No. 8,666/93, which determines the obligation to purchase a performance bond for public services and constructions whenever the same is requested in the invitation to bid.

Notwithstanding the previously specified mandatory insurance coverage directly and indirectly related to the construction market, contractors and related service providers usually purchase the following coverage, which may be part of one or more insurance policies:

- (a) engineering risks;
- (b) property;
- (c) third parties’ civil liability;
- (d) automobile liability;
- (e) employer’s civil liability;
- (f) bodily injury and physical damage, and life coverage for constructors’ employees;
- (g) coverage for the transportation of equipment to be used in the construction works;
- (h) performance bonds; and
- (i) environmental risks.

Despite there being no market practice, it is advisable for companies to be assisted by an insurance broker to assess all risks inherent to a particular project and determine the most suitable coverage.

1.7 Are there any statutory requirements in relation to construction contracts in terms of: (a) labour (i.e. the legal status of those working on site as employees or as self-employed sub-contractors); (b) tax (payment of income tax of employees); and/or (c) health and safety?

(a) Labour

In Brazil, employees’ basic labour rights are set forth in the Federal Constitution, which also establishes the minimum conditions that must be complied with in employment relationships. Labour rights and minimum conditions are also discussed in federal laws and most of them are restated in the Consolidation of Labour Laws (CLT). There are also mandatory regulations, established by means of collective bargaining agreements executed between one or more employers’ unions representing the companies, and one or more trade unions representing employees. The relationship between the contracting party and contractor, however, is governed by the BCC.

Hiring service providers through an intermediary company is possible. Some changes in the law regarding outsourcing (Law No. 6,019/1974) were enacted by the Brazilian Congress in order to reduce the unemployment rates and labour disputes related

to outsourcing. In addition, the Supreme Court confirmed the possibility of outsourcing in core business activities. After such changes and the Supreme Court's precedent, outsourcing is allowed in any activity of the companies, including core business.

Brazilian law does not require the execution of a written employment contract. However, to avoid uncertainties relating to conditions of employment, companies usually execute written employment contracts with employees, providing for the rights and duties to be performed by the parties. In some situations, such as for temporary workers, a written contract is mandatory.

(b) Tax

(b.1) Employees

In general terms, salaries paid to employees of Brazilian companies are subject to withholding of Social Security Tax at the maximum rate of 14% up to a maximum of R\$ 713.09, and to withholding of Income Tax (WHT) at progressive rates ranging from 0% up to 27.5%, as per the table below (applicable as from April 2015):

Monthly Tax Basis (R\$)	Tax Rate (%)	Portion to be Deducted (R\$)
Up to 1,903.98	-	-
From 1,903.99 to 2,826.65	7.5	142.80
From 2,826.66 to 3,751.05	15.0	354.80
From 3,751.06 to 4,664.68	22.5	636.13
Over 4,664.68	27.5	869.36

In addition to the above, Brazilian companies are subject to Social Security Tax at an approximate global rate of 28% on payroll. The legal taxpayer of such taxes is the employer, differing from the ones mentioned above, in which case the employer is only responsible for the withholding.

It is important to clarify that there is an alternative to the Social Security Tax on payroll for most construction companies, which is the payment of 4.5% on gross revenue. Such alternative is not mandatory; however, it may represent tax savings for companies with high payroll expenses.

(b.2) Self-Employed Sub-Contractors (Individuals)

The payment of income by Brazilian companies to self-employed individuals is also subject to WHT as indicated above. Please note, however, that payments to self-employed individuals are subject to withholding of Social Security Tax at a rate of 11% (considering the offset authorised by law of 9% subject to a maximum amount of R\$ 671.11).

In this case, Brazilian companies paying fees to self-employed sub-contractors are also subject to Social Security Tax at a rate of 20% on these payments.

The alternative reported above also applies here, and instead of contributing 20% over the payroll, some construction companies may contribute a rate of 4.5% on gross revenue.

Brazilian companies are also obligated to withhold 11% of payments made to other companies that render certain services.

In case the renderer of the service is subject to the payment of Social Security Tax on gross revenue, the withholding shall be made at a rate of 3.5%.

(c) Health and Safety

In Brazil, health and safety constitute main concerns in construction contracts and are regulated by: (i) the Federal Constitution, which establishes employees' rights, including, among others, the

reduction of risks inherent to works through compliance with health, hygiene and safety rules; (ii) CLT; (iii) Administrative Rulings (Ordinance No. 3,214/78 of the Ministry of Economy); (iv) rules and standards issued by ABNT; and (v) International Labour Organization Conventions.

The Ministry of Economy enacted Normative Resolutions regarding health and safety standards, which establish rules that must be complied with by the contractor and its employees. The most important points are:

(c.1) Specialised Work Safety and Medicine Service (*Serviços Especializados em Engenharia de Segurança e em Medicina do Trabalho – SESMET*)

Companies hiring more than 50 employees must have a SESMET, aiming to promote the protection of health and safety in the workplace.

The sizing of the SESMET will vary in accordance with the risk of a company's business (established by law) and the number of employees in a company.

(c.2) Accident Prevention Commission (*Comissão Interna de Prevenção de Acidentes – CIPA*)

Companies hiring more than 20 employees must have a CIPA, aiming to prevent occupational accidents or diseases.

The size of the CIPA will vary in accordance with the number of employees in a company.

(c.3) Programme for Medical Control of Occupational Health (*Programa de Controle Médico de Saúde Ocupacional – PCMSO*)

The PCMSO aims to promote and maintain the health of employees, emphasising the clinical and pathological aspects instrumental in addressing the relationship between health and work, from both an individual and collective perspective.

(c.4) Personal Protective Equipment (*Equipamentos de Proteção Individual – EPI*)

The company must provide its employees with personal protective equipment, aiming to neutralise/reduce the exposure to chemical, physical and/or biological agents.

(c.5) Environment Risk Prevention Programme (*Programas de Prevenção de Riscos Ambientais – PPRA*)

The PPRA aims to provide consulting services in the assessment and control of environmental risks, such as noise, heat, chemical agents, etc.

1.8 Is the employer legally permitted to retain part of the purchase price for the works as a retention to be released either in whole or in part when: (a) the works are substantially complete; and/or (b) any agreed defects liability period is complete?

The employer is allowed to retain part of the purchase price as a retention to be released either in whole or in part when the works are substantially complete, and/or any agreed defects liability period has expired, as long as the retention is supported by a contractual clause.

The retention right is meant to protect the employer against potential breaches by the contractor; nevertheless, it must not be abusive or the contractor might challenge it.

The BCC establishes that private contracts are governed by the principles of good faith and *pacta sunt servanda*, which means that contracts are laws with binding force between the contracting parties and require that every contracting party must keep its promises and fulfil the obligations undertaken. It is noteworthy

to mention that Law No. 13,874/19, which recently came into force and is known as the “Economic Freedom Law”, reinforces such principles as it provides for less court intervention in contract interpretation. Therefore, the amount of the retention and the conditions for its release shall be agreed upon by the contractual parties.

1.9 Is it permissible/common for there to be performance bonds (provided by banks and others) to guarantee the contractor’s performance? Are there any restrictions on the nature of such bonds? Are there any grounds on which a call on such bonds may be restrained (e.g. by interim injunction); and, if so, how often is such relief generally granted in your jurisdiction? Would such bonds typically provide for payment on demand (without pre-condition) or only upon default of the contractor?

In Brazil, it is common for construction contracts to provide for a performance bond in order to guarantee the fulfilment of the contractor’s obligations under such contract. The performance bond may be a bank guarantee, an insurance bond, or a combination of both.

Considering the ongoing crisis scenario from which Brazil is still recovering, contractors usually favour insurance bonds rather than bank guarantees, as these are more expensive and thus may create additional constraints for contractors due to the non-liquidity of the Brazilian market.

Although, in theory, performance bonds are not “on demand” guarantees in Brazil – as they are an accessory of the principal obligation – in effect, bank guarantees work as if they were “on demand”, given that local banks will rarely challenge or even discuss their foreclosure by the employer.

Given the preponderance of the principles of freedom of contract and of legal certainty, the Brazilian courts tend to rule against the restraints of insurance bonds, assuming that the parties complied with the previously stated legal requirements to create a legally binding contract.

Typically, the performance bonds provide that the contractor shall be in default in order to allow the employer to withdraw any payment under the bond.

1.10 Is it permissible/common for there to be company guarantees provided to guarantee the performance of subsidiary companies? Are there any restrictions on the nature of such guarantees?

The use of parent company guarantees in construction contracts is very common, especially when the contractor is not in a good financial standing and/or does not have sufficient assets to guarantee a possible default. The BCC provides that the amount of the guarantee shall not exceed the amount of the secured obligation.

1.11 Is it possible and/or usual for contractors to have retention of title rights in relation to goods and supplies used in the works? Is it permissible for contractors to claim that, until they have been paid, they retain title and the right to remove goods and materials supplied from the site?

The BCC provides for the possibility of sales with retention of title. However, legal provisions for retention of title are only applicable to goods that are capable of being identified and differentiated from their peers (e.g. equipment that can be identified through a serial number or vehicles).

In this sense, materials and goods applied in the works are normally not comprised within the scope of application of the BCC concerning retention of title. Notwithstanding, scholars, as well as parts of relevant case law, understand that the contractor may retain the title regarding goods and supplies used, as well as the right to remove from the site any goods and materials supplied, provided that: (i) the contractor has a credit right against the employer; (ii) there is a link between the credit and the goods/materials retained; (iii) the retention or the possession of the goods/materials is lawful; and (iv) the parties did not agree otherwise in the contract. Such situation may be altered in cases where the employer is subject to a judicial recovery procedure (*recuperação judicial*).

2 Supervising Construction Contracts

2.1 Is it common for construction contracts to be supervised on behalf of the employer by a third party (e.g. an engineer)? Does any such third party have a duty to act impartially between the contractor and the employer? If so, what is the nature of such duty (e.g. is it absolute or qualified)? What (if any) recourse does a party to a construction contract have in the event that the third party breaches such duty?

In Brazil, it is common, under construction contracts, for the employer to engage a third party to supervise the progress of works on its behalf. Nevertheless, such third party does not have a duty to act impartially between the contractor and employer. When the parties intend to have a third party to act impartially between the contractor and the employer, they usually hire an independent engineer or architect, or even an expert, as the case may be, to execute this specific task.

Dispute boards, the relevance of which has been increasing in the Brazilian construction market, may be considered an example of this. Dispute boards are committees composed of experienced and impartial professionals (in most cases engineers) hired before the commencement of the construction project to monitor the progress of the works, encouraging the parties to avoid disputes and assisting them when needed to solve those that cannot be avoided. The advantage of the dispute boards is that they can be appointed at the commencement of the project, taking responsibility to conduct regular visits to the site and to be directly involved in the works from the beginning, making recommendations and influencing the behaviour of the parties.

If the parties agree on contracting an impartial third party, legal and contractual sanctions (e.g. penalties and indemnification for losses) would apply if impartiality duties are breached. In the event of a dispute, the arbitral tribunal or court, depending on the case, may be called upon to settle it.

2.2 Are employers free to provide in the contract that they will pay the contractor when they, the employer, have themselves been paid; i.e. can the employer include in the contract what is known as a “pay when paid” clause?

The “pay when paid” clause is customarily found in sub-contracts, and purports to indicate that the payments to be made by the contractor to the sub-contractor shall only occur upon receipt by the contractor of the payments made by the final client (i.e. the employer).

Although the inclusion of this clause is not unusual, such provision may be challenged as being abusive if the sub-contractor

has fully and duly performed its contractual obligations – i.e. has supplied the goods and services contracted – without receiving the related payments.

The inclusion of a “pay when paid” clause is not possible in contracts entered into with public/governmental entities (Public Contracts). However, a private contractor may include a “pay when paid” provision in the sub-contracts related to a Public Contract, as long as the relevant Public Contract allows a sub-contracting part of the works.

2.3 Are the parties free to agree in advance a fixed sum (known as liquidated damages) which will be paid by the contractor to the employer in the event of particular breaches, e.g. liquidated damages for late completion? If such arrangements are permitted, are there any restrictions on what can be agreed? E.g. does the sum to be paid have to be a genuine pre-estimate of loss, or can the contractor be bound to pay a sum which is wholly unrelated to the amount of financial loss likely to be suffered by the employer? Will the courts in your jurisdiction ever look to revise an agreed rate of liquidated damages; and, if so, in what circumstances?

Brazilian law allows the parties to agree in advance on a penalty amount to be paid by the defaulting party in the event of a breach of the contract. Unlike common law, the Brazilian legal system accepts contractual penalty clauses, which may be due for delay/breach (penalty for delay) in performing a specific obligation or as compensation (compensation penalty) in case the entirety of the contract is breached.

The amount of the penalty clause does not necessarily need to represent a genuine pre-estimate of loss; however, in any case, it must be limited to the value of the breached obligation and may even be lowered in court should it be deemed patently excessive *vis-à-vis* the committed breach or if the main obligation has been partially performed.

Both the penalty for delay and the compensation penalty may have a similar function to liquidated damages (pre-determined damages), whereby the creditor may collect the penalties irrespectively of having incurred actual damages and the parties may agree that no further damages will be due in this case. Nevertheless, the parties may also agree that the contractual penalty does not preclude the claim for additional indemnification for damages arising out of the breach. In such case, the amount of damages specified in the contract is deemed to be the minimum amount of indemnification due. If the damages exceed this minimum amount, it is possible to recover additional indemnification from the breaching party. Additionally, according to the BCC, the party to which the penalties for delay are owed also has the right to require the performance of the delayed obligation.

3 Common Issues on Construction Contracts

3.1 Is the employer entitled to vary the works to be performed under the contract? Is there any limit on that right?

In private contracts, the employer usually may order variations on the works at any time prior to taking over the works.

Construction contracts usually include “change order provisions”, whereby the parties shall discuss the impact of the respective variation and, regarding material changes, negotiate a price adjustment and/or an extension of time.

If the contract does not provide for such variations’ provisions, the BCC will apply and the employer will be responsible for paying the additional costs arising from the variations requested by him. Notwithstanding, in case the variations requested by the employer are disproportionate to the design already approved, the contractor has the right to refuse the variation, even if the employer agrees to pay the additional costs.

Additionally, variations to reduce the scope of work are only allowed if expressly provided for in the contract and/or agreed between the parties, otherwise the employer may be required to indemnify the contractor for the losses and damages arising from such reduction.

With respect to Public Contracts, the employer (i.e. the public/governmental entity) may unilaterally vary the works whenever it is necessary to: (i) modify the design or the project specifications to better achieve the technical goals of the project; or (ii) increase or reduce the scope of the works. In both cases, the contractor is obliged to accept such variations under the same contractual conditions, provided that such increases or reductions to the works, services or purchases do not exceed 25% of the original price. This limit may be increased to up to 50% if the increases are related to restoration of buildings or equipment. In all cases, the economic and financial balance of the agreement shall be ensured.

The same limits related to increases or reductions of the works apply to contracts entered into by state-owned companies and mixed-capital companies. However, Federal Law No. 13,303/2016 provides that these modifications can only be implemented by means of negotiation between the parties. Therefore, state-owned companies and mixed-capital companies cannot increase or reduce the scope of the works without the private party’s consent.

3.2 Can work be omitted from the contract? If it is omitted, can the employer carry out the omitted work himself or procure a third party to perform it?

Please see our answer to question 3.1 regarding the reduction of the scope of work by the employer.

In case of reduction of the contractor’s scope of work, the employer may perform such works by himself or contract a third party to do it. Generally, a contractor will push back on providing a warranty in respect of any portions of the works performed by a third party.

With respect to Public Contracts, public tenders comprise a succession of steps provided for in the applicable laws that do not admit discretion on their fulfilment, except in specific cases contemplated by the law based on convenience and opportunity of the government; in such cases the tender may be waived. It is unlikely that the public employer would reduce the scope of a Public Contract and enter into another in order to perform part of the scope of the Public Contract in place. Nevertheless, there is no express prohibition of such practice. Therefore, if the work is completely omitted, the employer may do it himself or get a third party to do it.

3.3 Are there terms which will/can be implied into a construction contract (e.g. a fitness for purpose obligation, or duty to act in good faith)?

In the absence of a specific contractual obligation to the contrary, all applicable legal provisions that are not expressly stated in the contract will apply to the contract (e.g. five-year guarantee, time-bar, *force majeure*, limitation of liability with

respect to indirect damages and termination). The parties may expressly waive the application of certain legal provisions as long as they are not considered mandatory or of public policy.

It is noteworthy to mention that contracts under Brazilian law must always have regard for the social purpose of the contract and the principle of good faith, and that interpretation of contracts in Brazil will always consider the parties' real intention rather than the literality of words.

3.4 If the contractor is delayed by two concurrent events, one the fault of the contractor and one the fault or risk of his employer, is the contractor entitled to: (a) an extension of time; and/or (b) the costs arising from that concurrent delay?

The consequences arising from a delay caused by concurrent events may be agreed by the parties in the contract, and it has been noticed that "time but no money" approaches have increased among contractual arrangements. If there is specific provision addressing concurrent delays, each party's responsibility will be proportionate to the fraction of the delay it has caused.

Considering that the contractor's fault contributed to the delay, the employer shall not be required to pay the total costs regarding the concurrent delay and the contractor will not be entitled to an extension of time with respect to the whole period of the delay. The purpose is to avoid any imbalance and to compensate proportionally the employer's delay with the contractor's concurrent delay.

3.5 Is there a time limit beyond which the parties to a construction contract may no longer bring claims against each other? How long is that period and when does time start to run?

Brazilian law establishes different statutes of limitations depending on each case. The general rule provides for a 10-year period, usually counted from the date of the illicit act or violation, for the plaintiff to file its contractual claim. The BCC also states some specific cases in which the statute of limitations ranges from one to five years, counted from the date of certain events described in it.

The BCC also establishes that for construction comprising substantial equipment or buildings, the contractor shall be liable for the soundness and safety of the works performed during five years counted from the issuance of the taking-over certificate for the works. Such five-year warranty period may not be reduced by the parties to the contract. In case a defect is found during such period, the plaintiff may be required to file the claim within 180 days from the date it becomes aware of the defect. Certain scholars and parts of case law maintain that such term may be extended up to 10 years.

Please see also our answer to question 3.20.

3.6 Which party usually bears the risk of unforeseen ground conditions under construction contracts in your jurisdiction?

The allocation of the risk of unforeseen ground conditions will depend on the type of construction contract. Usually, in EPC lump-sum contracts, the rule is that such risk lies with the contractor. However, under Brazilian law, the risk is shifted to the employer when such unforeseen ground conditions are an extraordinary supervening event that places an excessively onerous obligation on the contractor.

The purposes of such legal provision are to: (i) prevent the unjust enrichment of the employer since it is the beneficiary of the works; and (ii) indicate that the employer, as the final beneficiary of the work, shall bear bad ground conditions whenever such conditions are unforeseeable and make the performance of the works excessively onerous on the contractor.

Although Brazilian law provides that, in such extraordinary cases, the risk of unforeseen ground conditions lies with the employer, the parties can alter it contractually.

3.7 Which party usually bears the risk of a change in law affecting the completion of the works under construction contracts in your jurisdiction?

Except if otherwise provided in the contract, the employer usually bears the risk of a change in law, mainly with respect to a tax burden and technical matters.

3.8 Which party usually owns the intellectual property in relation to the design and operation of the property?

Generally, the contract establishes which party owns the intellectual property rights in relation to the design and operation of the property. In most cases, the designer or the contractor, as the case may be, grants the employer a perpetual licence for the use of the intellectual property related to the design or operation of the property.

3.9 Is the contractor ever entitled to suspend works?

In the absence of contractual provisions to the contrary, the contractor may suspend the works without paying an indemnity to the employer due to: (i) the employer's fault (such as delays in obtaining applicable licences or authorisations); (ii) occurrence of *force majeure* events; (iii) changes resulting from unforeseeable events (such as geological, hydraulic or similar events), which affect the economic balance of the contract, resulting in excessively onerous obligations on the contractor; and (iv) disproportionate change orders requested by the employer with respect to the project already approved, even if the employer agrees to pay the additional costs.

3.10 Are there any grounds which automatically or usually entitle a party to terminate the contract? Are there any legal requirements as to how the terminating party's grounds for termination must be set out (e.g. in a termination notice)?

In case the parties did not stipulate the circumstances in which the contract could be terminated, Brazilian law provides that termination may occur in the following events: (i) fundamental breach; and/or (ii) occurrence of an extraordinary supervening event, which was unforeseeable to the parties and results in excessively onerous obligations on the party claiming the termination. In such cases, the claimant must request the termination from the relevant court or arbitral tribunal, as the case may be.

The parties are allowed to determine in the contract the termination events that shall apply, and even the termination at the convenience of either or both of them. The most common termination events are: (i) bankruptcy or insolvency; (ii) a breach not remedied within a specified period; (iii) delays in the works attributable to the contractor; and (iv) *force majeure* events continuing for a determined period of time agreed in the contract.

3.11 Do construction contracts in your jurisdiction commonly provide that the employer can terminate at any time and for any reason? If so, would an employer exercising that right need to pay the contractor's profit on the part of the works that remains unperformed as at termination?

Pursuant to Article 623 of the BCC, the employer may withdraw from the contract even when the execution of the works has already started, provided that the contractor is compensated for the expenses, the work done, costs incurred and profits in relation to the services already provided, plus a reasonable indemnification calculated in light of the gains that the contractor would receive if the works have been concluded.

Notwithstanding, the parties usually agree in the contract on specific termination for convenience provisions by the employer, stipulating more detailed criteria for the calculation of the indemnification due to the contractor in such scenario, which may include a termination penalty.

3.12 Is the concept of *force majeure* or frustration known in your jurisdiction? What remedy does this give the affected party? Is it usual/possible to argue successfully that a contract which has become uneconomic is grounds for a claim for *force majeure*?

The concept of *force majeure* is known and enforceable in Brazil. According to the BCC, *force majeure* shall be considered "the necessary event, whose effects were impossible to avoid or impair". The affected party shall not be responsible for losses resulting from *force majeure* events, unless such responsibility was expressly stated in the contract.

Thus, under Brazilian law, *force majeure* is a legal exemption of performance and liability during its occurrence. Under a contractual relationship, the party affected by a *force majeure* event will not be held liable for damages arising from it, provided that: (i) such party submits enough evidence of the event; and (ii) such event was unforeseeable and beyond the party's control.

In principle, each party will bear its respective expenses and costs resulting from the *force majeure* event, but it is possible to provide in the contract for a different allocation of such risk.

The parties may agree upon a contractual definition of *force majeure* and even waive the application to the contract of the concept established in the BCC. It is common to exclude certain events from the concept of *force majeure*, such as: (i) changes affecting the economic balance of the contract, even if the contract becomes uneconomic; (ii) labour or materials shortage; and (iii) strikes restricted to the contractor's employees.

3.13 Are parties, who are not parties to the contract, entitled to claim the benefit of any contractual right which is made for their benefit? E.g. is the second or subsequent owner of a building able to claim against the contractor pursuant to the original construction contracts in relation to defects in the building?

According to the BCC, a party that is not a party to a contract is entitled to claim the benefit of any right under said contract as long as the contract was executed for its benefit.

Brazilian law provides for a five-year guarantee with respect to the soundness and safety of the project. Therefore, a subsequent owner of a building may bring a claim against the contractor in case of any defect in the building during this period.

3.14 On construction and engineering projects in your jurisdiction, how common is the use of direct agreements or collateral warranties (i.e. agreements between the contractor and parties other than the employer with an interest in the project, e.g. funders, other stakeholders, and forward purchasers)?

Direct agreements are commonly executed between lenders and contractors, in order to grant lenders a step-in right enabling them to assume direct control of the project company and/or to remedy breaches by the employer that could jeopardise or terminate the project. Therefore, a contractor would not be able to terminate a contract due to a contractual breach by the employer, but must instead give the financing party an opportunity to remedy the default and/or take over the contract.

In this sense, the step-in clause limits in certain circumstances the contractor's ability to exercise the rights and remedies available to it under the contract and grants financing parties the right to step in and cure any default, as well as to assume any or all of the obligations of the employer under the contract.

3.15 Can one party (P1) to a construction contract, who owes money to the other (P2), set off against the sums due to P2 the sums P2 owes to P1? Are there any limits on the rights of set-off?

The set-off of credits is permitted by the BCC, provided that the debts have the same legal nature, are clear and defined, overdue and of fungible goods. Therefore, in this particular example, it is most likely to be possible.

3.16 Do parties to construction contracts owe a duty of care to each other either in contract or under any other legal doctrine? If the duty of care is extra-contractual, can such duty exist concurrently with any contractual obligations and liabilities?

The concept of duty of care is not applicable under Brazilian law. The parties are liable to each other in accordance with the terms of the contract and the provisions of the applicable law.

3.17 Where the terms of a construction contract are ambiguous, are there rules which will settle how that ambiguity is interpreted?

Ambiguity is settled by general rules of interpretation of the law, which are provided by the BCC, as amended by the previously mentioned Economic Freedom Law. Currently, the BCC establishes that a contract's interpretation must give it the meaning that: (i) is confirmed by the behaviour of the parties after its execution; (ii) is in accordance with the uses, customs and market common practices; (iii) is in accordance with good faith; (iv) is more beneficial to the party that did not write the provision, in case it is possible to distinguish the parties in such sense; and (v) is in accordance with what would be reasonably negotiated by the parties, taking into consideration the other provisions of the contract and the parties' economic condition, considering the information available at the time of its execution.

It is worth mentioning that the BCC, in Article 113, §2, inserted by the Economic Freedom Law, provides that the parties are free to agree on the rules of interpretation of the contract outside of those provided by law.

Lastly, Articles 421 and 421-A of the BCC, also amended by the Economic Freedom Law, provide that: (i) in private relations, there shall be minimum interference by the State and contract review should be exceptional; (ii) the negotiating parties may establish objective parameters for the interpretation of the negotiation clauses and their assumptions for review or resolution; (iii) the allocation of risk agreed between the parties should be preserved; and (iv) in business relationships, the parties are presumed to be equally equipped.

3.18 Are there any terms which, if included in a construction contract, would be unenforceable?

Contractual provisions contrary to public policy or mandatory law will be unenforceable. However, such assessment can only be made on a case-by-case basis.

3.19 Where the construction contract involves an element of design and/or the contract is one for design only, are the designer's obligations absolute or are there limits on the extent of his liability? In particular, does the designer have to give an absolute guarantee in respect of his work?

The designer can be contracted to provide design services either (i) without any interference in the performance of the works, or (ii) with the additional incumbency to supervise the works and give directions to the contractor.

In the first case, the responsibility of the designer is limited to the soundness and safety of the works related to the project for a five-year period, counted from the issuance of the taking-over certificate for the works. With respect to the second case, in addition to the above, the designer is also responsible for the damages caused to the employer for any omission related to the supervision of the performance of the works.

Please note that, under Brazilian law, the employer is not allowed to modify the design without the approval of the designer, except if the change is irrelevant or if it is required due to supervening events or technical reasons making the project inconvenient or excessively onerous. In case the design is changed without the designer's approval, the designer will not be liable for any damages resulting from such change.

3.20 Does the concept of decennial liability apply in your jurisdiction? If so, what is the nature of such liability and what is the scope of its application?

The BCC provides for decennial liability as the general rule that is applicable to civil liability whenever the law does not provide for a shorter period.

Over recent years, the Brazilian Superior Court of Justice (STJ) has been discussing whether such decennial liability period would apply to contractual liability, after divergence in the court where certain justices considered that a triennial liability period should apply in contractual relationships. At least for now, the STJ's understanding, as ruled in a decision taken in May 2019, is that the decennial period shall apply to contractual liability and the triennial period to non-contractual liabilities based on Article 205 of the BCC.

4 Dispute Resolution

4.1 How are construction disputes generally resolved?

If no amicable settlement is reached, disputes are usually resolved by arbitration. If no arbitration clause is provided for in the contracts, the disputes are resolved through court litigation.

4.2 Do you have adjudication processes in your jurisdiction (whether statutory or otherwise) or any other forms of interim dispute resolution (e.g. a dispute review board)? If so, please describe the general procedures.

Regarding dispute boards, please refer to our answer to question 2.1.

Brazilian law does not provide for statutory adjudication as in the UK. However, the inclusion of dispute boards in construction contracts has become more frequent in the past few years, which in practice creates a contractual adjudication mechanism for certain projects. In 2018, the Municipality of São Paulo passed the first law allowing and regulating the use of dispute review and adjudication boards in public procurement contracts executed by the Municipality.

4.3 Do the construction contracts in your jurisdiction commonly have arbitration clauses? If so, please explain how, in general terms, arbitration works in your jurisdiction.

Construction contracts usually provide for an arbitration clause.

In sum, Brazilian arbitration is regulated by federal law (Law No. 9,307/96, as amended by Law No. 13,129/15, which is based on the UNCITRAL Model Law and the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention)). Therefore, some important principles and features may be applied, such as due process, the right to be heard, impartiality and independence of arbitrators, *kompetenz-kompetenz*, and separability of the arbitration agreement, among many others.

Any party that can enter into a contract is permitted to submit disputes to arbitration. However, the dispute must relate to rights and assets that can be freely transferred by the parties.

Domestic awards – those rendered inside Brazilian territory – are considered as final judgments and do not require any confirmation by courts for the purposes of enforcement. Foreign awards, on the other hand, are subject to recognition proceedings within the STJ, in accordance with the New York Convention.

Parties are allowed to choose an arbitral institution to administer the case, the language, the law applicable to the dispute and the number of arbitrators to constitute the tribunal, as well as other procedural aspects related to the arbitration.

4.4 Where the contract provides for international arbitration, do your jurisdiction's courts recognise and enforce international arbitration awards? Please advise of any obstacles (legal or practical) to enforcement.

There is no legal concept defining international arbitration. Foreign arbitral awards (those rendered outside Brazil) do require recognition in order to be enforced in Brazil. However, it is fair to say that Brazilian courts tend to be friendly in the enforcement of arbitral awards.

The STJ has exclusive jurisdiction to recognise foreign arbitral awards, which must be executed through a recognition proceeding subject to STJ's Internal Rules, and in accordance with some requirements, such as authentication by a Brazilian consulate and a sworn Portuguese translation.

The defendant can object. The grounds for opposing enforcement of a foreign arbitral award are, however, limited to those provided for in the New York Convention, the Brazilian Arbitration Law, Law No. 4,657/42, the Code of Civil Procedure and STJ's Internal Rules, such as: (i) incapacity of the parties; (ii) invalidity of the arbitration agreement according to the law chosen by the parties or, failing any indication thereon, under the law of the country where the award was made; (iii) absence of proper notice and other impediments to presenting a proper defence; (iv) the award is rendered outside the scope of the arbitration agreement; (v) the arbitration proceedings were conducted contrary to the arbitration agreement; (vi) the award is not yet binding, or it was annulled or suspended by the courts of the country of the seat of the arbitration; or (vii) the award is contrary to Brazilian public policy, human dignity or Brazil's sovereignty.

The parties may only start the enforcement proceedings in the courts where the defendant is located after the award is recognised. Once recognition is granted, the creditor may file for enforcement before a federal court.

4.5 Where a contract provides for court proceedings in your jurisdiction, please outline the process adopted, any rights of appeal and a general assessment of how long proceedings are likely to take to reduce: (a) a decision by the court of first jurisdiction; and (b) a decision by the final court of appeal.

There are different court proceedings in Brazil. In a private contractual relationship, two proceedings could be used:

- (a) **ordinary procedure** – by which a party requests a declaration or recognition of a right and seeks to hold the other party liable to comply with a contractual obligation, pay a certain amount or indemnify for losses and damages caused to the plaintiff; and
- (b) **enforcement procedure** – by which the plaintiff uses the contract as a title (*título extrajudicial*) to enforce compliance with a specific contractual obligation or payment of a specific amount of money.

In the ordinary procedure, a lawsuit should normally comply with the following steps: (i) written statements of the plaintiff and the defendants; (ii) mediation or preliminary conciliatory hearing; (iii) taking of evidence; (iv) final statements; and (v) first instance judgment. Prior to judgment, only a few decisions can

be appealed. However, all first instance judgments are subject to appeal. The court of appeals is entitled to reanalyse facts and legal arguments of the parties, therefore confirming, annulling or modifying the judgment/decision. The court of appeals' decision can also be submitted to the STJ in case of violation or incongruent application of any federal law, or to the Federal Supreme Court in case of violation of any constitutional right.

Enforcement proceedings end by satisfaction of the debt/obligation or by withdrawal by means of a specific motion called "embargos". *Embargos* follows the same steps and procedural rules as an ordinary procedure.

In terms of the timing of civil court procedures, it depends on the complexity of the case and the courts in which the lawsuit is being processed. A fair assessment would be between five and 10 years, if the case goes to the higher courts. In the courts of first instance, ordinary procedures take one to five years; and in the courts of appeal, another six months to three years, depending on the jurisdiction where the lawsuit is filed.

4.6 Where the contract provides for court proceedings in a foreign country, will the judgment of that foreign court be upheld and enforced in your jurisdiction? If the answer depends on the foreign country in question, are there any foreign countries in respect of which enforcement is more straightforward (whether as a result of international treaties or otherwise)?

Enforcing a foreign judgment is only possible after such judgment is recognised by the STJ. Therefore, a party seeking to enforce a foreign court judgment must fulfil some legal procedural requirements, as described in our answer to question 4.4 above, which include, among other requirements contained in STJ's Internal Rules and the Code of Civil Procedure: to prove that the decision is protected by *res judicata*; to indicate the jurisdiction of the authority that granted the decision; and to present the sworn translation of the decision into Portuguese. Furthermore, foreign judgments must not violate public policy, human dignity or Brazil's sovereignty.

Moreover, according to Article 25 of the Brazilian Code of Civil Procedure, provisions providing for the competence of foreign courts only exclude the jurisdiction of Brazilian courts in cases where the contract is considered to be an international contract. In cases where Brazilian courts consider the contract not to be international, they may claim that either court (national or foreign) has jurisdiction over the dispute. In that case, if a Brazilian issues a final and binding decision on the case prior to the recognition of the foreign decision, the recognition shall be denied.



Thiago Fernandes Moreira concentrates his practice on construction and complex contracts, including onshore and offshore contracts, equipment supply contracts, contracts typical to the oil and gas industry (e.g. charter agreements, O&M agreements, FPSOs, DPUs and platform construction contracts, and gas supply contracts), take-or-pay contracts, contracts related to the hotel industry (e.g. construction of hotels, built to suit, hotel management agreements and franchising), as well as project development and infrastructure-related transactions. His experience includes advice to owners and contractors on the preparation, negotiation, pre-litigation and arbitration involving complex contracts. He has substantial experience in sectors such as energy, ports, airports, subways, railways, shipbuilding, and oil and gas. Prior to joining Mattos Filho, Thiago worked for the Inter-American Investment Corporation (IDB Group) in Washington, D.C. He is a member of the Society of Construction Law in London and is currently the Co-Vice Chair of the Project Execution Subcommittee of the International Construction Projects Committee of the International Bar Association (IBA).

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1 Making Construction Projects

1.1 What are the standard types of construction contract in your jurisdiction? Do you have: (i) any contracts which place both design and construction obligations upon contractors; (ii) any forms of design-only contract; and/or (iii) any arrangement known as management contracting, with one main managing contractor and with the construction work done by a series of package contractors? (NB For ease of reference throughout the chapter, we refer to “construction contracts” as an abbreviation for construction and engineering contracts.)

The standard types of construction contract used in Mainland China are (i) build-only contracts, (ii) design-only contracts, (iii) design-and-build contracts, and (iv) engineering, procurement and construction contracts. Management contracting is not considered common.

1.2 How prevalent is collaborative contracting (e.g. alliance contracting and partnering) in your jurisdiction? To the extent applicable, what forms of collaborative contracts are commonly used?

The construction contracting market in Mainland China is still fairly traditional (please refer to the answer to question 1.1). There is limited understanding of what collaborative contracting is. Both alliance contracting and partnering are not considered common.

1.3 What industry standard forms of construction contract are most commonly used in your jurisdiction?

The most commonly used standard forms for the PRC domestic market are the model forms published by the PRC Government (jointly published by the Ministry of Housing and Urban-Rural Development (“**MOHURD**”) and the State Administration for Market Regulation (“**SAMR**”). They are not mandatory forms but are quite commonly used (with amendments). These model forms include:

- *For build-only*: Model Contract for Construction Works (GF-2017-0201).
- *For design-only*: Model Engineering Contract for Civil Construction Projects (GF-2015-0209) and Model Engineering Contract for Specialist Construction Projects (GF-2015-0210).
- *For EPC*: Model Engineering, Procurement and Construction Contract (GF-2011-0216).

For private projects in Mainland China involving foreign-invested employers, the suite of contract forms published by FIDIC (the International Federation of Consulting Engineers), known as the “Rainbow Suite” (both the 1999 First Edition and the 2017 Second Edition), is one of the more commonly used non-government model forms. Among them, the “Red Book” (for construction), the “Yellow Book” (for plant and design-build) and the “Silver Book” (for EPC/turnkey projects) are the most commonly used forms.

1.4 What (if any) legal requirements are there to create a legally binding contract (e.g. in common law jurisdictions, offer, acceptance, consideration and intention to create legal relations are usually required)? Are there any mandatory law requirements which need to be reflected in a construction contract (e.g. provision for adjudication or any need for the contract to be evidenced in writing)?

Under PRC law, in broad terms, the following are the necessary requirements for a contract to be legally binding: (a) an offer; (b) acceptance of that offer; (c) the intentions of the parties to create legal relations and that they have the capacity to do so; and (d) the contract terms do not contravene mandatory provisions in laws and administrative regulations and are not against public interest.

As far as construction contracts are concerned, the minimum requirements are that (i) they are in writing, and (ii) they contain essential terms. The essential terms are the contracting parties, the subject matter of the contract and the quantity of the subject matter being contracted for.

Depending on a number of factors such as (a) the contract value, (b) the source of funding of the project, and (c) whether it qualifies as a major national construction project, a construction contract may need to be awarded through tendering and go through formal investment planning and a feasibility study process.

There is no statutory adjudication for the construction industry in Mainland China and so no provision for adjudication in the contract terms.

1.5 In your jurisdiction please identify whether there is a concept of what is known as a “letter of intent”, in which an employer can give either a legally binding or non-legally binding indication of willingness either to enter into a contract later or to commit itself to meet certain costs to be incurred by the contractor whether or not a full contract is ever concluded.

A “letter of intent” is more often used in projects not procured through tendering – if a construction contract is let through

tendering, the *PRC Bidding Law* requires that the response to a successful bid is an award of the contract, often in the form of a “letter of award”, as opposed to issuing a “letter of intent” or a “limited notice to proceed” (with the works).

There are no specific legal principles under PRC law used for determining the effect of “letters of intent”. The provisions in the *PRC Contract Law* will apply in determining whether it creates legally binding obligations, especially whether it is sufficient to constitute a “pre-contract” under PRC law. A “pre-contract” is an agreement between the parties to enter into a formal contract within an agreed period of time.

If a letter of intent is general in content and does not specify the subject matter of the contract and the quantity of the subject matter to be contracted for, in some judicial cases the PRC courts have found that the letter is not legally binding.

If a letter of intent does not refer to a contract to be entered into, or a draft contract, but it stipulates that a party will meet certain costs to be incurred by the other party, this may be regarded by the PRC courts as a unilateral undertaking by the employer, which will be legally binding on the employer.

If a letter of intent stipulates or indicates the parties’ intention to enter into a contract, is signed by the contractor to confirm its agreement to the terms of the letter and refers to the specific draft contract to be entered into or otherwise specifies the subject matter of the contract and the quantity of the subject matter to be contracted for, this may constitute a pre-contract under PRC law. Such pre-contract will oblige the employer to enter into a formal contract with the contractor. If the employer decides not to do so, it will be in breach of the pre-contract.

1.6 Are there any statutory or standard types of insurance which it would be commonplace or compulsory to have in place when carrying out construction work? For example, is there employer’s liability insurance for contractors in respect of death and personal injury, or is there a requirement for the contractor to have contractors’ all-risk insurance?

Under the *PRC Construction Law*, when carrying out construction work, a contractor should have in place work injury insurance for its employees. Pursuant to the *Administrative Regulations on Work Safety for Construction Projects*, a contractor should have in place accident liability insurance for employees that engage in dangerous operations (what constitutes dangerous operations is not defined) – the carrying of accident liability insurance is also encouraged under the *PRC Construction Law*, but the *Administrative Regulations on Work Safety for Construction Projects* make it compulsory.

The other most common types of insurance (although not mandatory) include construction/erection all-risk insurance, public/third-party liability insurance and insurance that covers a contractor’s construction equipment. Where it is the employer (i.e. project owner) who takes out the construction/erection all-risk insurance, it is not uncommon to see that coverage will be extended to cover losses for delay in start-up (especially for production plant construction).

There is no mandatory requirement in the PRC for construction professionals to maintain professional liability/indemnity insurance.

1.7 Are there any statutory requirements in relation to construction contracts in terms of: (a) labour (i.e. the legal status of those working on site as employees or as self-employed sub-contractors); (b) tax (payment of income tax of employees); and/or (c) health and safety?

In terms of labour, there is no general requirement under PRC law for a minimum portion of the works or services to be undertaken by or subcontracted to Chinese nationals or companies. Generally speaking, all lawfully employable persons can be engaged to perform work or services either as an employee or as a sub-contractor. In an employer-employee relationship, the *PRC Labour Law* and the *PRC Labour Contract Law* will apply.

In terms of tax, as with any party employing individuals, under PRC law a contractor has a general obligation to withhold (as the statutory tax withholding agent) the Individual Income Tax amounts from the income to be released to its employees and pay the tax amounts directly to the tax authorities. The withholding and direct payment arrangement is not unique to the construction sector or construction contractors. Value-added tax also applies to construction contractors (in their capacity as service suppliers).

In terms of health and safety, the mandatory statutory requirements are provided for in various laws and regulations. By way of example:

- contractors shall establish a work safety management institution and staff it with full-time work safety management personnel;
- contractors shall establish a safety training system for employees and workers and take out accident liability insurance for employees who engage in dangerous operations (refer to the answer to question 1.6). Workers who have not completed their work safety education and training are not permitted to commence works on site;
- contractors shall provide personal protection equipment and clothing to operatives, inform them of the operational procedures for dangerous operations, and alert them to the hazards of operating in violation of the rules and regulations; and
- as an employer, contractors shall make arrangements for occupational health check-ups prior to, during and after the end of employment for their employed workers engaged in operations that may expose them to occupational hazards.

1.8 Is the employer legally permitted to retain part of the purchase price for the works as a retention to be released either in whole or in part when: (a) the works are substantially complete; and/or (b) any agreed defects liability period is complete?

Yes, the employer is legally permitted to take retentions, to be released in whole or in part on completion and/or on the expiry of the defects liability period and the completion of defects rectification. The *Measures on the Management of Construction Project Quality Deposits* (“Measures”), jointly issued by the Ministry of Finance and MOHURD, stipulate that retentions shall not exceed 3% of the contract price and the defects liability period shall not exceed two years. However, the Measures, carrying only the status of a *department regulatory document*, are not considered to be mandatory requirements. It is quite common for employers to retain between 5% and 10% of the contract price as retentions, with at least 5% of it only to be released after the defects liability period expires and the defects are all rectified.

1.9 Is it permissible/common for there to be performance bonds (provided by banks and others) to guarantee the contractor's performance? Are there any restrictions on the nature of such bonds? Are there any grounds on which a call on such bonds may be restrained (e.g. by interim injunction); and, if so, how often is such relief generally granted in your jurisdiction? Would such bonds typically provide for payment on demand (without pre-condition) or only upon default of the contractor?

The use of performance bonds is both permissible and common. There are no general restrictions on the nature of such bonds, and both independent bonds (creating a primary obligation on the bondsman to pay) and traditional contracts of guarantee (creating a secondary obligation to pay) are used in the PRC construction market. Typically, independent performance bonds are issued as on-demand bonds, whilst contracts of guarantee are conditional and do require default of the contractor, as described in the guarantee, to be established.

It is possible for a call on an independent performance bond to be restrained by the courts (by forbidding payment) on limited grounds, but the evidential threshold for making out a case is considered high. Generally speaking, following the issuance in late 2016 of the *Provisions of the Supreme People's Court on Several Issues concerning the Trial of Independent Guarantee Dispute Cases*, the PRC courts may issue a ruling to temporarily forbid payment under an on-demand bond if all of the following conditions are satisfied:

- the applicant has submitted sufficient evidence to establish a highly likely case that “*the beneficiary made a fraudulent bond call*”;
- it is urgent and the applicant may suffer irreparable damage if payment is not stopped; and
- the applicant has lodged with the court sufficient counter-guarantee or counter-security for the application.

Interim injunctions temporarily forbidding bond payments are difficult to obtain because of the high evidential burden of proof required, and thus the number of such injunctions granted is limited as a matter of court practice.

1.10 Is it permissible/common for there to be company guarantees provided to guarantee the performance of subsidiary companies? Are there any restrictions on the nature of such guarantees?

It is permissible for parent companies to provide guarantees for the performance of subsidiary companies, but it is not common practice in the PRC construction market. There are no general restrictions on the nature of such guarantees under law, but in order for the guarantee to be valid, the provision of the guarantee will have been approved by way of a shareholder resolution or a board resolution (as required by the *PRC Company Law*), and the guaranteed amount must also be in line with the requirements prescribed in the company's articles of association.

1.11 Is it possible and/or usual for contractors to have retention of title rights in relation to goods and supplies used in the works? Is it permissible for contractors to claim that, until they have been paid, they retain title and the right to remove goods and materials supplied from the site?

It is possible for the parties to agree for the contractor to retain title, insofar as the goods and supplies have not been incorporated into the works, and to remove them from the site under

specified conditions (e.g. in the event of non-payment). The right to remove goods and materials from the site in the event of non-payment is, however, not commonly provided to the contractor in contracts – employers in Mainland China seldom agree to this.

However, the *PRC Contract Law* does give the contractor a priority right (over other creditors) to compensation if the employer defaults in paying the contractor. Article 286 of the *PRC Contract Law* provides that, if the employer fails to pay the price for the works as agreed, then after demanding such payment from the employer and giving the employer a reasonable period thereafter to pay, if the employer still fails to pay, the contractor may apply to the court for the liquidation or auction of the project in accordance with law, except projects that are by their nature unsaleable. The contractor shall have the right to be compensated from the proceeds of the liquidation or auction sale, prior to mortgagees, chargees and other creditors over the project, if any. However, this right needs to be exercised within six months of the project completion date, and the compensation will be limited to payment for the materials and manpower supplied, and does not include, for example, damages for breach of contract.

2 Supervising Construction Contracts

2.1 Is it common for construction contracts to be supervised on behalf of the employer by a third party (e.g. an engineer)? Does any such third party have a duty to act impartially between the contractor and the employer? If so, what is the nature of such duty (e.g. is it absolute or qualified)? What (if any) recourse does a party to a construction contract have in the event that the third party breaches such duty?

It is common for an employer to appoint a third party to supervise the construction project on its behalf. Under PRC law, the appointment by the employer of a project supervisor (a “*Jian Li*”) is mandatory for the following projects:

- key construction projects of the State;
- large and medium-scale public utility projects;
- large-area residential development projects;
- projects using loans or aids from foreign governments or international organisations; and
- other projects that should be subject to project supervision as stipulated by the law.

Under PRC law, the role of a project supervisor is not one of contract administration for the employer. The *Regulations on the Quality Management of Construction Projects* impose various statutory duties on project supervisors. By way of example, the project supervisor shall possess a qualification certificate of the required grade and shall not:

- act beyond the scope of its licensed qualification;
- conduct supervision in the name of another project supervision entity;
- assign the project supervision for others to perform; or
- supervise a project where he has a subsidiary relationship or any other relationship of interest with the contractors or the suppliers.

There are administrative penalties and, in some circumstances, even criminal liability for the project supervisor if he is found to be in breach of his statutory duties. If he is in breach of his project supervision contract with the employer, he will be liable to the employer for the losses caused by his breach. In the Model Contract Form for Project Supervision jointly published by the MOHURD and SAMR (GF-2012-0202), it is stipulated that the project supervision shall be carried out in a fair,

independent, honest and scientific manner. It is noteworthy that “project supervision” in this context is not contract administration for the employer.

If a third-party contract administrator is appointed by the employer, there is no general duty for this contract administrator (who can be an engineer) to act impartially between the parties.

2.2 Are employers free to provide in the contract that they will pay the contractor when they, the employer, have themselves been paid; i.e. can the employer include in the contract what is known as a “pay when paid” clause?

Yes. PRC law does not prohibit the stipulation of “pay when paid” clauses or arrangements in main contracts, but they are not common in Mainland China since, in practice, the establishment of most construction projects in Mainland China will have required the employer to have secured sufficient funding at the outset of the project formation.

“Pay when paid” clauses or arrangements, if used, are more often at the subcontract level. Generally speaking, there is no prohibition against “pay when paid” clauses and, as such, they can be enforceable. However, in judicial practice, in order to avail itself of the “defence”, the main contractor typically has to satisfy the court evidentially that it actively demanded payment from the employer and that it is not due to its own reasons that the conditions for payment under the main contract have not been satisfied.

2.3 Are the parties free to agree in advance a fixed sum (known as liquidated damages) which will be paid by the contractor to the employer in the event of particular breaches, e.g. liquidated damages for late completion? If such arrangements are permitted, are there any restrictions on what can be agreed? E.g. does the sum to be paid have to be a genuine pre-estimate of loss, or can the contractor be bound to pay a sum which is wholly unrelated to the amount of financial loss likely to be suffered by the employer? Will the courts in your jurisdiction ever look to revise an agreed rate of liquidated damages; and, if so, in what circumstances?

Yes. Parties are free to agree liquidated damages for breach in the contract, including for late completion. This is permitted under the *PRC Contract Law*. However, the *PRC Contract Law* also allows the court to revise the agreed rate of liquidated damages, effectively to ensure that the total damages are not less than the actual losses suffered, in the following manner:

- (a) If the liquidated damages are significantly higher than the actual losses suffered and one party applies to the court for a reasonable deduction, the court may consider adjusting the rate of liquidated damages. Based on subsequent judicial clarification, typically if the liquidated damages are more than 30% higher than the actual losses suffered, it will be regarded as being significantly higher than actual losses. In practice, in addition to considering the amount of the actual losses, the court will look into other factors such as the performance of the contract concerned, the extent of culpability of the relevant party in causing the losses suffered and the anticipated benefits from the contract performance, and then decide whether to adjust the liquidated damages in accordance with the principles of justice, fairness and good faith.
- (b) If the liquidated damages are lower than the actual losses suffered, then on a party's application, the court may increase the amount of the liquidated damages and such increased amounts shall not exceed the actual losses suffered.

A party will also generally not be allowed to claim compensation by way of both liquidated damages and general damages in respect of the same loss.

3 Common Issues on Construction Contracts

3.1 Is the employer entitled to vary the works to be performed under the contract? Is there any limit on that right?

The right to vary the works to be performed under a construction contract is not expressly provided for under PRC law, but invariably construction contracts provide for such a right, to be exercised prior to completion. By way of example, the Model Contract for Construction Works (GF-2017-0201) provides for the employer's right to vary the works.

3.2 Can work be omitted from the contract? If it is omitted, can the employer carry out the omitted work himself or procure a third party to perform it?

The right to omit work under a construction contract is not enshrined under PRC laws and regulations. Rather, it is left to the parties to agree between themselves. In practice, even if it is not expressly agreed, it is generally taken as the position that the employer may omit work (often as part of its express right to vary the works) and perform it either itself or have it performed by a third party.

3.3 Are there terms which will/can be implied into a construction contract (e.g. a fitness for purpose obligation, or duty to act in good faith)?

By way of implication of terms by law, the *PRC Contract Law* imposes a number of general obligations on contracting parties in their contract performance including, amongst others, the obligation:

- (a) to comply with laws and regulations and to respect social codes of conduct;
- (b) not to disrupt socioeconomic order or impair social and public interests;
- (c) to perform the parties' respective obligations under the contract;
- (d) to provide notifications and assistance to other parties;
- (e) to maintain confidentiality regarding the contract; and
- (f) to comply with the principle of good faith.

There is, however, no implied fitness for purpose obligation under PRC law for construction works and construction design.

3.4 If the contractor is delayed by two concurrent events, one the fault of the contractor and one the fault or risk of his employer, is the contractor entitled to: (a) an extension of time; and/or (b) the costs arising from that concurrent delay?

PRC law is silent on whether a contractor is entitled to an extension of time and/or additional payment in the event of concurrent delays. This issue very much turns on the terms of the parties' contract. Unless otherwise provided under a contract, it is, in principle, possible for the contractor to claim for time and cost consequences of delay events for which it is not responsible, even if these events may be concurrent with other, non-excusable events.

3.5 Is there a time limit beyond which the parties to a construction contract may no longer bring claims against each other? How long is that period and when does time start to run?

According to Article 188 of the *General Principles of the Civil Law*, the time limit for the parties to bring claims under a contract (including a construction contract) is three years. Time starts to run from the day when the aggrieved party knows or ought to have known that his or her right has been violated (i.e. breach).

3.6 Which party usually bears the risk of unforeseen ground conditions under construction contracts in your jurisdiction?

It is common in practice for the employer to bear the risk of unforeseen ground conditions under construction contracts. The Model Contract for Construction Works (GF-2017-0201), for instance, provides that in the event that the contractor encounters unforeseen ground conditions, it shall take reasonable measures to overcome such conditions and is entitled to an extension of time and additional payment for any delays or costs it has incurred as a result of taking such measures. Similarly, insofar as EPC contracting is concerned, pursuant to Article 15 of the *Measures for Administration on EPC Contracting for Houses and Infrastructure Projects* jointly issued by MOHURD and the National Development and Reform Commission in December 2019, the risk of unforeseen ground conditions is also allocated to the employer for EPC works.

3.7 Which party usually bears the risk of a change in law affecting the completion of the works under construction contracts in your jurisdiction?

The risk of a change in law is usually borne by the employer. This practice is reflected in the Model Contract for Construction Works (GF-2017-0201), which provides that the employer is responsible for any increase in costs incurred by the contractor for the execution of the contract as a result of any change in law after the base date of the contract. Similarly, insofar as EPC contracting is concerned, pursuant to Article 15 of the *Measures for Administration on EPC Contracting for Houses and Infrastructure Projects* (please refer to the answer to question 3.6), the employer bears the risk of a change in contract price caused by a change in law for EPC works. Although in both of the above cases, there is no express stipulation as to which party should bear the time implication, if any, of a change in law, consistent with the allocation of risk to the employer in both cases, it is expected that a contractor's application for extension of time resulting from a change in law will likely be supported by the courts.

3.8 Which party usually owns the intellectual property in relation to the design and operation of the property?

Under PRC law, unless otherwise agreed by the parties, the intellectual property in relation to the design and operation of the property is owned by the party creating it. In construction contracts, the intellectual property of any documents prepared by the contractor in the course of its performance of the construction contract is usually agreed to be owned by the employer. The contractor is, however, usually entitled to copy and use these documents for the purpose of carrying out, commissioning, or executing repair and modification to the works under the construction contract.

3.9 Is the contractor ever entitled to suspend works?

Under PRC law, the contractor is entitled to suspend works in certain situations, such as where the employer fails to make payment. The statutory grounds for suspension of performance of a contract are, however, limited. Parties usually expressly stipulate the grounds for suspension under construction contracts.

3.10 Are there any grounds which automatically or usually entitle a party to terminate the contract? Are there any legal requirements as to how the terminating party's grounds for termination must be set out (e.g. in a termination notice)?

The general grounds for termination of a contract are set out in the *PRC Contract Law*. Article 93 gives parties a right to terminate a contract by mutual consent. Article 94 further allows either party to terminate where:

- (a) the objective of the contract may no longer be achieved due to *force majeure*;
- (b) the other party clearly indicates by word or conduct an intention not to perform its obligation before the obligation is due to be performed;
- (c) the other party delays performance of its obligation and, after being requested to perform such obligation, fails to do so within a reasonable period;
- (d) the objective of the contract may no longer be achieved due to the other party's delay in performance of its obligations or other breaches of contract; or
- (e) there is any other circumstance as stipulated by law.

Additional grounds for termination under a construction contract are set out in the *Interpretation of the Supreme People's Court on Issues Concerning the Application of Law for the Trial of Cases of Dispute over Contracts on Undertaking Construction Projects*. According to it, the employer is entitled to terminate the contract if:

- (a) the contractor clearly indicates by word or conduct an intention not to perform its obligation before the obligation is due to be performed;
- (b) the contractor fails to complete the works by the agreed date of completion and thereafter within a reasonable time after receiving the employer's notice to do so;
- (c) the contractor refuses to rectify works that are sub-standard; or
- (d) the contractor illegally assigns the construction contract.

In the event that the employer fails to perform its obligations despite being requested to do so by the contractor, the contractor is entitled to terminate the contract if the following circumstances render it impossible for the contractor to carry out the construction works:

- (a) the employer fails to make a payment due under the contract;
- (b) the employer provides construction materials, parts and equipment that do not meet the relevant mandatory technical standards; or
- (c) the employer fails to perform its contractual obligations to provide assistance.

To terminate a contract, the terminating party must give notice of termination to the other party. The contract shall be terminated upon the receipt of the notice by the other party.

3.11 Do construction contracts in your jurisdiction commonly provide that the employer can terminate at any time and for any reason? If so, would an employer exercising that right need to pay the contractor's profit on the part of the works that remains unperformed as at termination?

The employer has no express right under PRC law to terminate a contract for convenience. The employer can only terminate the contract on the statutory grounds mentioned in the answer to question 3.10 above. The parties are, however, free to include a right to terminate for convenience under construction contracts and to specify the entitlements arising from the optional termination. It is quite common that construction contracts do provide for such a right for the employer to terminate for convenience. However, it is much less often that there will be clear stipulation in the contract that the contractor will be compensated for the loss of profit on the part of the works unperformed.

3.12 Is the concept of *force majeure* or frustration known in your jurisdiction? What remedy does this give the affected party? Is it usual/possible to argue successfully that a contract which has become uneconomic is grounds for a claim for *force majeure*?

The concept of *force majeure* is recognised under PRC law and is enshrined in Article 180 of the *General Principles of the Civil Law*: it defines *force majeure* as circumstances that are unforeseeable, unavoidable and insurmountable. In practice, however, PRC courts are unlikely to find that a contract that has become uneconomic, in itself, will give rise to a claim for *force majeure*. In the event of *force majeure*, the party affected may, depending on the circumstances, be relieved in whole or in part from its liability for failure of contract performance.

There is no formal concept of frustration under PRC law but there is a recognised legal principle/remedy of “change of circumstances” which offers relief in appropriate situations. The general principle/remedy of “change of circumstances” is laid out in the *Interpretation of the Supreme People's Court on Several Issues Concerning Application of the “Contract Law of the People's Republic of China” (2)*. Article 26 therein provides that, if there is a significant change of the objective circumstances which renders the continual performance of the contract manifestly unfair to the relevant party, or makes it impossible to achieve the objective of the contract, and if such change could not have been foreseen by the parties at the time of entering into the contract and is not due to *force majeure* or commercial risks, the relevant party may apply to the courts to have the contract amended or discharged. The affected party may seek judicial relief from the courts, either in the form of amendment(s) to the contract or the termination of the contract, and the courts may make a decision based on the facts and the principle of fairness. Based on judicial practice, it is usually not easy for a party to argue change of circumstances successfully, especially if it is obvious that a party is merely seeking to get out of contractual arrangements that have become uneconomic.

3.13 Are parties, who are not parties to the contract, entitled to claim the benefit of any contractual right which is made for their benefit? E.g. is the second or subsequent owner of a building able to claim against the contractor pursuant to the original construction contracts in relation to defects in the building?

It is possible under PRC law for a third party to claim the benefit of a contractual right if that party is the intended beneficiary of

such right. This principle, however, does not apply in cases where the second or subsequent owner of a building discovers defects in the building; such owner has no right to claim pursuant to the original construction contract for its losses resulting from the defects against the contractor. The right to bring a claim for defects against the contractor pursuant to the original construction contract rests with the party with whom the contractor entered into the contract.

3.14 On construction and engineering projects in your jurisdiction, how common is the use of direct agreements or collateral warranties (i.e. agreements between the contractor and parties other than the employer with an interest in the project, e.g. funders, other stakeholders, and forward purchasers)?

Whilst it is possible for parties to conclude direct agreements or issue collateral warranties under PRC law, this is not common practice for construction projects in Mainland China.

3.15 Can one party (P1) to a construction contract, who owes money to the other (P2), set off against the sums due to P2 the sums P2 owes to P1? Are there any limits on the rights of set-off?

The *PRC Contract Law* recognises the right of set-off. Such right arises in cases where one party (P1) owes the other party (P2) a sum that has become due under the contract, in which case such sum can be set off by P1 against any sums that P2 owes to P1. The right of set-off is not available if it is excluded by contract or by law.

3.16 Do parties to construction contracts owe a duty of care to each other either in contract or under any other legal doctrine? If the duty of care is extra-contractual, can such duty exist concurrently with any contractual obligations and liabilities?

There are certain requirements under PRC law that broadly echo the principle of duty of care. For instance, Article 60 of the *PRC Contract Law* imposes on contracting parties the general duty to perform their contractual obligations and the duty of good faith. Article 60 also imposes on contracting parties the general obligations to provide notifications, provide assistance and maintain confidentiality, subject to the nature and objective of the contract and trade customs. These duties and obligations under PRC law exist concurrently with the parties' contractual obligations.

There is otherwise no formal duty of care (comparable to that in tort in common law jurisdictions) owed by the parties towards each other.

3.17 Where the terms of a construction contract are ambiguous, are there rules which will settle how that ambiguity is interpreted?

Article 125 of the *PRC Contract Law* provides that, where the parties dispute the effect of a contractual clause, the actual meaning of the clause shall be inferred and determined by reference to: the words and sentences used in the contract; the relevant provisions of the contract; the objective of the contract; trade customs; and the principle of good faith.

3.18 Are there any terms which, if included in a construction contract, would be unenforceable?

Under the *PRC Contract Law*, the following clauses are invalid and thus unenforceable:

- (a) Exemption clauses that exempt one party's liabilities for causing physical injury to another party, or for causing the other party to suffer losses either intentionally or by gross negligence (Article 52).
- (b) Standard clauses that either (i) exempt the party proposing those clauses from liabilities, (ii) increase the extent of the other party's liability, or (iii) exclude substantive rights of the other party (Article 40).

3.19 Where the construction contract involves an element of design and/or the contract is one for design only, are the designer's obligations absolute or are there limits on the extent of his liability? In particular, does the designer have to give an absolute guarantee in respect of his work?

Under PRC law, the liabilities for design defects are stipulated in Article 73 of the *PRC Construction Law*. Article 73 provides that, in the event that design works fail to meet relevant quality and safety standards:

- (a) the designer shall rectify the non-compliance and be liable for fines;
- (b) if such non-compliance causes quality-related incidents, the designer shall suspend its business operations, have its qualification downgraded or revoked, surrender any unlawful proceeds and be liable for fines;
- (c) if such non-compliance causes damage or losses to other parties, the designer shall compensate the same; and
- (d) if such non-compliance constitutes a criminal offence, the designer shall be subject to prosecution.

In practice, the parties are free to limit their design liability (other than criminal liability) under the contract. This is typically at, or by reference to, the design portion of the contract price, together with the usual exclusions of indirect losses, loss of profits, etc.

3.20 Does the concept of decennial liability apply in your jurisdiction? If so, what is the nature of such liability and what is the scope of its application?

Whilst the concept of decennial liability is not expressly enshrined under PRC law, contractors remain liable for defects in the works during statutory quality warranty periods. Article 40 of the *Regulations on the Quality Management of Construction Projects (Revision 2017)* provides the following minimum warranty periods in relation to construction works:

- (a) for infrastructure works, ground foundations works and main structural works for building construction, the quality warranty period shall be the reasonable design life as specified in the design documents;
- (b) for roofing and waterproofing works, the quality warranty period shall be five years;
- (c) for heating and air-conditioning systems, the quality warranty period shall be two cycles of heating or air-conditioning periods; and
- (d) for works regarding electric wiring, gas, water supply, drainage pipes, equipment installation and renovation works, the quality warranty period shall be two years.

The warranty period runs from the day when the works are accepted. During this period, the contractor will be liable to make good any defects in the works.

4 Dispute Resolution

4.1 How are construction disputes generally resolved?

In Mainland China, construction disputes are generally resolved through litigation or arbitration. The parties are also free to resolve disputes through consultation or mediation. Whichever form of dispute resolution they prefer and choose, it is important that the parties' choice is expressed clearly in their contract.

The use of multi-tiered dispute resolution processes is not very common for projects in Mainland China.

4.2 Do you have adjudication processes in your jurisdiction (whether statutory or otherwise) or any other forms of interim dispute resolution (e.g. a dispute review board)? If so, please describe the general procedures.

There is no statutory adjudication for the construction industry in Mainland China.

The Model Contract for Construction Works (GF-2017-0201) provides for the use of a dispute review board ("DRB") mechanism. Generally speaking, DRB may comprise a single member or a panel of three members. The parties to the contract shall appoint the DRB members within 28 days after the contract is signed or within 14 days after the dispute arises. The parties to the contract may jointly submit a dispute relating to the contract to the DRB for review at any time.

The DRB shall, within 14 days of receiving a dispute for review, make a written and reasoned decision in accordance with relevant laws, norms, standards, case experience and business practice. The written decision made by the DRB shall be binding on both parties after being signed and confirmed by the parties to the contract and both parties shall comply with the same. If either party does not accept or comply with the decision of the DRB, the parties may refer the dispute to arbitration or litigation, as agreed.

4.3 Do the construction contracts in your jurisdiction commonly have arbitration clauses? If so, please explain how, in general terms, arbitration works in your jurisdiction.

In Mainland China, it is not uncommon for parties to include an arbitration clause in their construction contracts. According to the *PRC Arbitration Law*, an arbitration agreement must include:

- (a) the expression of the parties' intention to refer disputes to arbitration;
- (b) the scope of matters for arbitration; and
- (c) the arbitration commission chosen by the parties.

The more popular (and among the busiest) arbitration institutions in Mainland China include the China International Economic and Trade Arbitration Commission, the Beijing Arbitration Commission and the Shenzhen Court of International Arbitration. Generally speaking, as a method of dispute resolution in China, arbitrations tend to be more flexible than litigation.

4.4 Where the contract provides for international arbitration, do your jurisdiction's courts recognise and enforce international arbitration awards? Please advise of any obstacles (legal or practical) to enforcement.

According to the *PRC Civil Procedure Law*, arbitral awards issued by foreign arbitration institutions can be recognised and enforced in Mainland China.

The PRC is a Contracting State to the *United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards* (the “**New York Convention**”). The local law (*PRC Civil Procedure Law*, see below) in relation to recognising and enforcing foreign arbitral awards made in another Contracting State now largely mirrors the grounds for refusal of recognition and enforcement in the New York Convention. Where a Chinese court is inclined to refuse enforcement of a foreign arbitral award, it must follow a vertical reporting system to seek non-objection to its intended decision to refuse from all higher courts (including the Supreme People’s Court) before making an order for refusing enforcement.

The grounds for refusing an application for the recognition and enforcement of foreign arbitral awards in Mainland China are provided for in Article 274 of the *PRC Civil Procedure Law* and are as follows:

- (a) the parties have neither included an arbitration clause in their contract nor subsequently reached a written arbitration agreement;
- (b) the person against whom the application is made was not requested to appoint an arbitrator or take part in the arbitration proceedings, or he was unable to state his opinions due to reasons for which he is not responsible;
- (c) the constitution of the arbitral tribunal or the arbitration procedure was not in conformity with the arbitration rules; or
- (d) matters decided in the award exceed the scope of the arbitration agreement or are beyond the arbitral authority.

If the court determines that the enforcement of the award would be against public interest, it shall also refuse enforcement.

4.5 Where a contract provides for court proceedings in your jurisdiction, please outline the process adopted, any rights of appeal and a general assessment of how long proceedings are likely to take to reduce: (a) a decision by the court of first jurisdiction; and (b) a decision by the final court of appeal.

In general, court proceedings in Mainland China can be divided into first instance proceedings and appeal proceedings. According to the *PRC Civil Procedure Law*, a people’s court shall close first instance proceedings within six months of the date the case was filed. This time limit can be extended by six months with the prior approval of the president of the court. If

a party disagrees with a judgment or ruling of first instance, it may file an appeal with a higher-level people’s court within 15 days from the date on which the judgment comes into effect or, in the case of a ruling, within 10 days from the date on which the ruling comes into effect.

The appeal court shall investigate and review the facts and issues determined by the first instance court. If there are no new facts, evidence or causes of action, the court may dispense with the need for an oral hearing. The appeal court is to render a judgment within three months of the filing of the appeal, subject to extension with the prior approval of the president of the court.

For simple and uncontroversial civil cases involving facts, rights and obligations that are relatively clear-cut, a summary procedure may be applied in the first instance. In that case, the court is to render a judgment within three months of the filing of the case.

4.6 Where the contract provides for court proceedings in a foreign country, will the judgment of that foreign court be upheld and enforced in your jurisdiction? If the answer depends on the foreign country in question, are there any foreign countries in respect of which enforcement is more straightforward (whether as a result of international treaties or otherwise)?

A judgment of a foreign court can be recognised and enforced in Mainland China in accordance with a bilateral or multinational treaty concluded or acceded to by the PRC, or under the principle of reciprocity, provided that such judgment is not detrimental to the sovereignty, security or public interest of the PRC.

The PRC has signed mutual judicial assistance treaties in relation to civil or commercial matters with more than 30 countries, such as Singapore, Korea, France and Italy. Pursuant to such treaties, the foreign judgments in those countries can be recognised and enforced in Mainland China. Although a special administrative region of the PRC, Hong Kong SAR is considered a separate jurisdiction from Mainland China. There is a formal framework in place providing for the mutual recognition and enforcement of civil judgments between Mainland China and Hong Kong SAR (as are there similar formal frameworks in place for the mutual recognition and enforcement of arbitral awards between Mainland China and Hong Kong SAR).

In instances where there is no mutual judicial assistance treaty between the PRC and a foreign country, PRC courts may also recognise and enforce court judgments from that country based on the principle of reciprocity, particularly if there are precedents that the foreign country has previously recognised and enforced PRC court judgments. On this basis, PRC courts have recognised and enforced court judgments from Singapore and the United States (California).



Michelle Li has over 15 years' experience advising Chinese and international clients on construction contracts, claims, disputes, as well as transactional matters, with a particular focus on the infrastructure and energy sectors, including power, oil & gas, petrochemicals, chemicals, mining, railways and expressways. Michelle's clients include contractors, employers, consultants, as well as banks.

As part of her contentious practice, Michelle advises and assists Chinese and international clients in arbitration, court litigation and mediation in many jurisdictions, such as Mainland China, Hong Kong SAR, Singapore, Sweden, London and other Southeast Asian and African nations. Michelle regularly speaks at conferences and seminars on the subject of construction risks, claims and dispute management. She has taught classes on construction arbitration, international construction and project management, resolving Belt and Road disputes and investor-state arbitration at programmes organised by Tsinghua University. She is recognised in *Who's Who Legal: Construction* as a Future Leader (Partners).

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Splitting his time between Shanghai and Beijing, Hew lectures on construction law issues at seminars organised by the Chinese government and is a member of the Panel of Arbitrators of CIETAC, SHIAC and BAC. Hew was appointed Vice Chair of the Legal Committee of China Association of International Engineering Consultants (CAIEC) (which operates under the auspices of the Ministry of Commerce) and consistently invited to speak on Belt & Road issues at the annual CAIEC Summit.

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Gregers Gam

1 Making Construction Projects

1.1 What are the standard types of construction contract in your jurisdiction? Do you have: (i) any contracts which place both design and construction obligations upon contractors; (ii) any forms of design-only contract; and/or (iii) any arrangement known as management contracting, with one main managing contractor and with the construction work done by a series of package contractors? (*NB* For ease of reference throughout the chapter, we refer to “construction contracts” as an abbreviation for construction and engineering contracts.)

A committee appointed by the Minister for Climate, Energy and Building has prepared several documents which have the status of “agreed documents” and which consist of:

- General conditions for building and construction works and supplies (AB 18), where the contractor carries out the building and construction works, and where the design, drawings, descriptions, etc. are mainly supplied by the employer.
- General conditions for design and build contracts (ABT 18), where the contractor both supplies the design and carries out the works.
- General conditions for consultancy services for building and construction works (ABR 18), which are commonly agreed between the employer and the employer’s consultant and/or the contractor and the contractor’s consultant.

When the terms and conditions in AB 18, ABT 18 or ABR 18 (the “AB Standards”) are agreed between the parties, they apply alongside the specific contract. Deviation from the AB Standards is then only valid if the points to be deviated from are clearly and explicitly specified in the specific construction contract.

1.2 How prevalent is collaborative contracting (e.g. alliance contracting and partnering) in your jurisdiction? To the extent applicable, what forms of collaborative contracts are commonly used?

Partnering is not commonly used in Denmark; however, it is not an unfamiliar concept. Four Danish industrial organisations in the construction industry have produced a guide to partnering in practice (*Partnering i praksis – vejledning i partnering*, 2. ed. 2005), which also contains three paradigms for partnering contracts.

1.3 What industry standard forms of construction contract are most commonly used in your jurisdiction?

The AB Standards described in question 1.1 are the most commonly used standard forms.

1.4 What (if any) legal requirements are there to create a legally binding contract (e.g. in common law jurisdictions, offer, acceptance, consideration and intention to create legal relations are usually required)? Are there any mandatory law requirements which need to be reflected in a construction contract (e.g. provision for adjudication or any need for the contract to be evidenced in writing)?

According to the Danish Contracts Act, an agreement is legally binding once an offer has been made and that offer has been accepted. There are, in general, no formal requirements requiring, e.g., that the agreement be in writing, registered, signed or approved.

The AB Standards prescribe that the construction contract is to be concluded in writing. However, this is not a requirement for the contract to be valid, but a party arguing that an oral agreement has been concluded bears the burden of proof in documenting that this is the case.

1.5 In your jurisdiction please identify whether there is a concept of what is known as a “letter of intent”, in which an employer can give either a legally binding or non-legally binding indication of willingness either to enter into a contract later or to commit itself to meet certain costs to be incurred by the contractor whether or not a full contract is ever concluded.

Pursuant to Danish case law, the general rule is that a letter of intent is not legally binding for the parties. However, dependent on its content – including a specification that certain provisions are to be considered legally binding and/or subsequent behaviour by the parties – the letter of intent can entail legal consequences, *cf.* Gam, Letters of Intent, *Erbvervsjuridisk Tidsskrift* 2009/3, pp. 247–260.

1.6 Are there any statutory or standard types of insurance which it would be commonplace or compulsory to have in place when carrying out construction work? For example, is there employer’s liability insurance for contractors in respect of death and personal injury, or is there a requirement for the contractor to have contractors’ all-risk insurance?

In accordance with AB 18 and ABT 18, the employer is obliged to take out and pay for fire and storm damage insurance.

The parties can agree to a more extensive insurance obligation for the employer or the contractor such as all-risk insurance, and such agreement is common in large building or civil engineering work contracts.

The contractor(s) must take out professional and product liability insurance. This insurance will include cover for damages to the employer's or a third party's person or property, but there are notable exceptions to cover of particular relevance to construction works, including that such insurance does not cover damage to objects that the insured has accepted to install, repair, mount or in other ways rework or treat, where the damage is caused during performance of these works.

If the building is to be mainly used for residency, the employer must take out building damage insurance, *cf.* the Danish Building Act, unless the building is intended to be rented out.

1.7 Are there any statutory requirements in relation to construction contracts in terms of: (a) labour (i.e. the legal status of those working on site as employees or as self-employed sub-contractors); (b) tax (payment of income tax of employees); and/or (c) health and safety?

In relation to labour, all employees who are not citizens in the EU, the Nordics, the EEA or Switzerland must obtain a residence and work permit in Denmark.

When determining whether a worker is an employee or a self-employed subcontractor, it is essential if the works are performed on the worker's own account and risk.

Whether an employee is liable to pay tax in Denmark will depend on sections 1 and 2 of the Danish Withholding of Tax Act. For instance, the employee will be liable to pay tax in Denmark if the employee has taken residence in Denmark or if the work is performed in Denmark. If the employee is liable to pay tax in Denmark, the contractor will be obliged to withhold tax when paying wages.

If the employee is employed by a foreign firm and is then hired out by a Danish contractor to perform work in Denmark, the employee will be liable to pay 8% labour market contributions and 30% hiring-out of labour tax on gross earnings. The contractor will pay this tax on behalf of the employee.

Denmark's taxation rights can be limited by double taxation treaties.

The employer and contractors working on the construction site must comply with the provisions of the Danish Working Environment Act and the statutory orders issued under the provisions of this Act.

1.8 Is the employer legally permitted to retain part of the purchase price for the works as a retention to be released either in whole or in part when: (a) the works are substantially complete; and/or (b) any agreed defects liability period is complete?

According to AB 18 and ABT 18, the employer may retain a reasonable amount of the purchase price as security for the rectification of defects detected at the time of handover. The retained amount must be reasonable in relation to the extent of the detected defects and the expected costs of rectification.

1.9 Is it permissible/common for there to be performance bonds (provided by banks and others) to guarantee the contractor's performance? Are there any restrictions on the nature of such bonds? Are there any grounds on which a call on such bonds may be restrained (e.g. by interim injunction); and, if so, how often is such relief generally granted in your jurisdiction? Would such bonds typically provide for payment on demand (without pre-condition) or only upon default of the contractor?

Under AB 18 and ABT 18, both the employer and the contractor

are obliged to provide a performance bond as security for the due performance of their obligations towards one another. This does not apply to the employer if the employer is a public employer or social housing organisation.

The contractor's performance bond must correspond to 15% of the contract sum excluding VAT. After handover, the performance bond is reduced to 10% and then again to 2% one year after handover. Five years after handover, the performance bond ceases. These reductions take place unless the employer prior hereto has submitted a written complaint of the defects, in which case the reductions are made once the defects are remedied.

The employer's performance bond must correspond to three months' average payments, but no less than 10% of the contract sum excluding VAT. It will cease once the contractor has submitted the final account and has no outstanding claims.

For both the employer's and the contractor's performance bonds, the parties can request payment in writing by simultaneously notifying the other party and the guarantor. A call on the performance bond must be paid within 10 working days, unless the other party files a request with the Danish Building and Construction Arbitration Board, asking the Board to issue a decision on the security provided. It is not uncommon for full or partial relief to be granted on a call on a bond.

1.10 Is it permissible/common for there to be company guarantees provided to guarantee the performance of subsidiary companies? Are there any restrictions on the nature of such guarantees?

According to AB 18 and ABT 18, performance bonds must be in the form of a bank guarantee, fidelity insurance or other adequate type of security.

A guarantee from a parent company will not be sufficient as "other adequate type of security", hence neither the contractor nor the employer will be obliged to accept such a guarantee.

1.11 Is it possible and/or usual for contractors to have retention of title rights in relation to goods and supplies used in the works? Is it permissible for contractors to claim that, until they have been paid, they retain title and the right to remove goods and materials supplied from the site?

If AB 18 or ABT 18 has been agreed and not deviated from, materials and other supplies intended for incorporation in the works must be supplied by the contractor without any retention of title. Once such materials and supplies have been delivered to the construction site, they belong to the employer.

2 Supervising Construction Contracts

2.1 Is it common for construction contracts to be supervised on behalf of the employer by a third party (e.g. an engineer)? Does any such third party have a duty to act impartially between the contractor and the employer? If so, what is the nature of such duty (e.g. is it absolute or qualified)? What (if any) recourse does a party to a construction contract have in the event that the third party breaches such duty?

According to AB 18, the employer must appoint a supervisor to represent the employer in relation to the contractor with regard to the organisation and execution of the work. The supervisor will often be the employer's technical advisor. Such an agreement will most often be based on ABR 18.

There is no duty to act impartially between the employer and the contractor, but the supervisor should be independent of the employer. There is a general contractual duty to act in good faith (please see question 3.3).

2.2 Are employers free to provide in the contract that they will pay the contractor when they, the employer, have themselves been paid; i.e. can the employer include in the contract what is known as a “pay when paid” clause?

The parties may include a “pay when paid” clause in their contract. Such a clause is rarely seen in the contracts with the employer, but is sometimes found in the contractor’s subcontracts. It cannot be ruled out that such clause would be considered unreasonably burdensome, and the parties must therefore be aware of the risk that a Danish court will modify or set aside the clause.

2.3 Are the parties free to agree in advance a fixed sum (known as liquidated damages) which will be paid by the contractor to the employer in the event of particular breaches, e.g. liquidated damages for late completion? If such arrangements are permitted, are there any restrictions on what can be agreed? E.g. does the sum to be paid have to be a genuine pre-estimate of loss, or can the contractor be bound to pay a sum which is wholly unrelated to the amount of financial loss likely to be suffered by the employer? Will the courts in your jurisdiction ever look to revise an agreed rate of liquidated damages; and, if so, in what circumstances?

The parties are free to agree on liquidated damages in the event of breach of contract. Most contracts contain an agreement on liquidated damages. The parties often agree on a daily penalty fixed as a percentage of the contract sum.

There are no specific requirements or restrictions on such an agreement. However, the Danish courts can revise an agreed rate of liquidated damages if the agreement is deemed unreasonable. The amount that can be claimed as liquidated damages may, by agreement, be capped.

3 Common Issues on Construction Contracts

3.1 Is the employer entitled to vary the works to be performed under the contract? Is there any limit on that right?

According to AB 18 and ABT 18, the employer can order variations to the works. Such variations can consist of the employer ordering the contractor to supply a service in addition to or instead of a service originally agreed, or that the nature, quality, type or execution of a service is changed.

The employer’s right to order variations is not unlimited as it is a requirement that any variations are naturally linked to the services agreed in the construction contract. The employer’s right to order variations is also balanced by the contractor’s right (to the exclusion of others) to perform the variation, unless the employer can show particular reasons why others should perform the variation.

3.2 Can work be omitted from the contract? If it is omitted, can the employer carry out the omitted work himself or procure a third party to perform it?

The employer is entitled to order that services agreed upon

are omitted. The AB Standards do not specifically regulate the employer’s right to transfer the omitted works to another contractor but, based on the AB-committee’s report no. 1570 (2018), the employer will most likely not be entitled to perform the work himself or to instruct a third party to perform it.

3.3 Are there terms which will/can be implied into a construction contract (e.g. a fitness for purpose obligation, or duty to act in good faith)?

In Danish contract law, the parties to a contract have a general duty to act in good faith towards one another. This has been codified in the AB Standards and applies towards all parties involved in the construction project.

According to AB 18 and ABT 18, works are to be performed in accordance with the contract, good professional practices and the employer’s instructions. A general “fitness for purpose” obligation, to the extent that this reflects an objective, no-fault warranty as known under English law, is not implied into construction contracts based on AB 18 and ABT 18.

However, if the materials used in the construction project are directly unfit for the purpose, the materials can be deemed defective. This issue has recently been tried before the Danish Building and Construction Arbitration Board in several cases regarding the use of MgO-plates.

There is no question that MgO-plates are unfit to use in Denmark, as the Danish climate causes the boards to break down. The question in these cases was who was liable for the use of unfit MgO-plates. This depended on whether the damages could be considered development damages, meaning damages that develop over time even though the works were performed in compliance with the general knowledge at the time of construction. If this is the case, the employer bears the risk.

In the cases where the MgO-plates were used either prior to becoming generally accepted or after the issues with the plates became known, the Arbitration Board decided against development damages. If the Board decided against development damages, the liability was placed on either the contractors or the employer’s advisors, depending on the structure of the contracts, which party had the design obligation and which party made the decision to use the MgO-plates.

The cases stress that the parties to a construction project should exercise caution if using new and untested materials.

3.4 If the contractor is delayed by two concurrent events, one the fault of the contractor and one the fault or risk of his employer, is the contractor entitled to: (a) an extension of time; and/or (b) the costs arising from that concurrent delay?

The principle of “time, no money” (the Malmaison doctrine) has recently been recognised in Danish case law.

This only applies if the two concurrent events are in fact independent and of equal importance. For instance, if the delaying event which is the fault or risk of the employer is insignificant compared to the event which is the fault of the contractor, the contractor will not be entitled to an extension of time.

The contractor will also be entitled to an extension of time due to other reasons such as *force majeure* or public enforcement notices and prohibitions, which are not the fault of either the employer or the contractor.

In addition to an extension of time, the contractor may be entitled to compensation. If the delay is caused by the employer’s error or neglect, the contractor will be entitled to compensation for loss sustained. If the employer has not shown error

or neglect, but the event still relates to the employer's circumstances, the contractor will only be entitled to partial compensation. The same applies if the delay is caused by public enforcement notices and prohibitions. In case of *force majeure*, the contractor will not be entitled to compensation.

3.5 Is there a time limit beyond which the parties to a construction contract may no longer bring claims against each other? How long is that period and when does time start to run?

Pursuant to the Danish Statute of Limitations Act, the standard limitation period is three years from the time when the claimant could have demanded the claim be fulfilled. If the claimant is not and should not be aware of the claim's existence, the limitation period can be suspended up to a maximum of 10 years.

AB 18 and ABT 18 prescribe both a relative and an absolute deadline to present claims regarding defects detected after hand-over. The employer can only present such claims if the contractor has been notified in writing within a reasonable period of time after the defects were or should have been discovered. Such claims must be submitted no longer than five years after hand-over, after which the contractor's liability for defects ceases.

3.6 Which party usually bears the risk of unforeseen ground conditions under construction contracts in your jurisdiction?

According to AB 18 and ABT 18, the employer will, as a general rule, bear the risk of unforeseen ground conditions, as the employer must provide adequate information on hindrances with respect to ground conditions.

3.7 Which party usually bears the risk of a change in law affecting the completion of the works under construction contracts in your jurisdiction?

The risk of changes in law being implemented after the contractor's offer is usually borne by the employer.

3.8 Which party usually owns the intellectual property in relation to the design and operation of the property?

If AB 18 has been agreed, the consultant owns all rights to ideas developed and material prepared by the consultant. The employer will be entitled to use the material prepared for the project, which entails a right to execute the project and subsequently operate, maintain, alter and extend the property.

3.9 Is the contractor ever entitled to suspend works?

In accordance with AB 18 and ABT 18, the contractor is entitled to suspend works if the employer fails to pay an amount due and provided that the contractor has given a written notice of three working days.

The contractor is also entitled to suspend works if the employer is declared bankrupt, is subjected to reconstruction proceedings or if the employer's financial situation is of such nature that the employer must be assumed to be unable to meet its obligations. However, if the employer has provided adequate security for the performance of the remainder of the contract, the contractor will not be entitled to suspend works.

3.10 Are there any grounds which automatically or usually entitle a party to terminate the contract? Are there any legal requirements as to how the terminating party's grounds for termination must be set out (e.g. in a termination notice)?

If AB 18 or ABT 18 have been agreed, the employer will be entitled to terminate the contract in whole or in part with immediate effect:

- if the contractor causes material actionable delay in the execution of the works where such delay causes substantial inconvenience to the employer;
- if the contractor causes other material delay with regard to matters of decisive importance to the employer;
- if the works executed are of such quality that the employer has reason to believe that the contractor will not be able to complete the works without material defects; or
- if the contractor otherwise commits a material breach with regard to matters of decisive importance to the employer.

The contractor will be entitled to terminate the contract with immediate effect:

- in the event of a material delay as a result of the circumstances of the employer or a delay on the part of another contractor where the employer does not make reasonable efforts to expedite the works to the fullest possible extent; or
- if the employer causes other material delay or commits a material breach with regard to matters of decisive importance to the contractor.

In addition, both parties are entitled to terminate the contract in the event of the other party's bankruptcy, subject to the limitations found in the Danish Bankruptcy Act.

Notice of termination must be given in writing while also issuing a written notice summoning the parties to attend a registration meeting (status meeting).

3.11 Do construction contracts in your jurisdiction commonly provide that the employer can terminate at any time and for any reason? If so, would an employer exercising that right need to pay the contractor's profit on the part of the works that remains unperformed as at termination?

The employer may terminate the construction contract without probable cause, which in itself is a breach of contract entitling the contractor to damages, which includes profit on the part of the works that remains unperformed.

3.12 Is the concept of *force majeure* or frustration known in your jurisdiction? What remedy does this give the affected party? Is it usual/possible to argue successfully that a contract which has become uneconomic is grounds for a claim for *force majeure*?

Force majeure has been incorporated into AB 18 and ABT 18 in relation to both the risk of damage to/loss of the works and in relation to delays.

In the event of damage to or loss of the works caused by exceptional external events beyond the control of the contractor, the employer will bear the risk.

In relation to delays, both the employer and the contractor will be entitled to an extension of time in the event of circumstances that are without the fault and beyond the control of the party in question. In respect of the employer, the events must also be beyond the control of other contractors working on the contract.

In general, it is not possible to argue that a contract which has become uneconomic constitutes *force majeure*, but in certain circumstances, a party may be released from its obligations to perform under the contract due to such performance exceeding the threshold of sacrifice.

3.13 Are parties, who are not parties to the contract, entitled to claim the benefit of any contractual right which is made for their benefit? E.g. is the second or subsequent owner of a building able to claim against the contractor pursuant to the original construction contracts in relation to defects in the building?

A second or subsequent owner of the building, who is not entitled under the original construction contract, can potentially pursue claims against the contractor based on the principle of succession or a claim in tort.

A claim based on the principle of succession will be subject to the condition that the third party's contracting party would be able to make the same claim towards the contractor. Such direct claims can be limited by terms in the construction contract.

If the claim is based on tort, the contractor must have acted in a way giving rise to liability towards the third party. Such a claim will not be limited by the terms in the construction contract.

3.14 On construction and engineering projects in your jurisdiction, how common is the use of direct agreements or collateral warranties (i.e. agreements between the contractor and parties other than the employer with an interest in the project, e.g. funders, other stakeholders, and forward purchasers)?

Forward purchasing agreements and collateral warranties are increasingly common in Danish real estate development projects.

3.15 Can one party (P1) to a construction contract, who owes money to the other (P2), set off against the sums due to P2 the sums P2 owes to P1? Are there any limits on the rights of set-off?

The right of set-off is recognised under Danish law, if certain mandatory conditions are met. The right of set-off can be limited by contract and certain claims are precluded from the right to set-off by mandatory law.

3.16 Do parties to construction contracts owe a duty of care to each other either in contract or under any other legal doctrine? If the duty of care is extra-contractual, can such duty exist concurrently with any contractual obligations and liabilities?

A duty to act in good faith towards one's contracting parties is a general principle in Danish law (please see question 3.3).

3.17 Where the terms of a construction contract are ambiguous, are there rules which will settle how that ambiguity is interpreted?

If certain terms of a construction contract are ambiguous, such terms are interpreted in accordance with the intended meaning of the term. It can also be interpreted using a linguistic method or to the disadvantage of the party who drafted it.

In the case of conflict between terms in the contract documents, the AB Standards prescribe in which priority the documents will apply.

3.18 Are there any terms which, if included in a construction contract, would be unenforceable?

According to the Danish Contracts Act, a contract can be modified or set aside as a whole or in part if terms or the agreement itself are deemed unreasonable or in conflict with common decency.

The AB Standards do not contain any terms which would be unenforceable.

3.19 Where the construction contract involves an element of design and/or the contract is one for design only, are the designer's obligations absolute or are there limits on the extent of his liability? In particular, does the designer have to give an absolute guarantee in respect of his work?

The contractor/designer will be liable to perform the works and supply any design agreed upon. There is no general obligation to supply an absolute guarantee of the work.

If ABT 18 has been agreed, the contractor's liability will expire five years after handover and the contractor will not be liable for loss of business, loss of profit or other indirect loss.

If ABR 18 has been agreed, the consultant's liability will expire five years after the conclusion of services or handover. The consultant will not be liable for loss of business, loss of profit or other indirect loss. If project liability insurance has been taken out, the consultant's liability is limited to the cover provided by the insurance policy. If not, the consultant's liability is limited to twice the agreed consultancy fee, but no less than DKK 2.5 million.

3.20 Does the concept of decennial liability apply in your jurisdiction? If so, what is the nature of such liability and what is the scope of its application?

In accordance with the Danish Statute of Limitations Act, the absolute limitation period is 10 years from the time when the claimant could have demanded the claim be fulfilled (please see question 3.5).

4 Dispute Resolution

4.1 How are construction disputes generally resolved?

In Denmark, legal disputes are generally resolved by public court proceedings. However, if the new AB Standards have been agreed, the terms dictate a so-called dispute resolution ladder.

First, efforts must be made to resolve and settle a dispute between the parties through negotiation between the parties' project managers. The procedure for the negotiations is prescribed in the AB Standards. If these negotiations are unsuccessful, the next step can consist of mediation, conciliation, speedy resolution or arbitration.

It is also possible to initiate an expert appraisal or decision on security provided. This can be requested without preceding negotiations, for the expert appraisal, subject to the condition that it is necessary to ensure evidence which may otherwise be lost.

4.2 Do you have adjudication processes in your jurisdiction (whether statutory or otherwise) or any other forms of interim dispute resolution (e.g. a dispute review board)? If so, please describe the general procedures.

The AB Standards provide for the use of different adjudication processes such as decisions on security provided or speedy resolution.

At the request of a party and after having heard the parties, the Danish Building and Construction Arbitration Board appoints an expert to make a decision on security provided. The AB Standards provide the procedure for such decision.

At the request of a party and after having heard the parties, the Danish Building and Construction Arbitration Board appoints one or more umpires to make a speedy resolution. The procedure is similar to decisions on security provided; however, speedy resolution is applicable for a wider selection of disputes.

Dispute review boards are also commonly agreed upon, but not included in the AB Standards.

4.3 Do the construction contracts in your jurisdiction commonly have arbitration clauses? If so, please explain how, in general terms, arbitration works in your jurisdiction.

According to the dispute resolution ladder prescribed in the AB Standards, disputes are finally resolved by arbitration before the Danish Building and Construction Arbitration Board. The arbitral procedure is governed by the Danish Arbitration Act and rules prepared by the Board.

4.4 Where the contract provides for international arbitration, do your jurisdiction's courts recognise and enforce international arbitration awards? Please advise of any obstacles (legal or practical) to enforcement.

In accordance with section 38 of the Danish Arbitration Act, Denmark both recognises and enforces international arbitration awards, *cf.* also Gam, Recognition of foreign judgments and arbitral awards under Danish law, *Ugeskrift for Retsvæsen* 2013B, p. 185 *ff.* The party seeking the recognition and enforcement of the award must present a certified copy of both the award and the arbitration agreement with, where applicable, a certified Danish translation.

Recognition and enforcement of an international arbitration award can only be refused if one of the reasons listed in section 39(1) of the Danish Arbitration Act applies, which matches those found in the UNCITRAL Model Law.

4.5 Where a contract provides for court proceedings in your jurisdiction, please outline the process adopted, any rights of appeal and a general assessment of how long proceedings are likely to take to reduce: (a) a decision by the court of first jurisdiction; and (b) a decision by the final court of appeal.

In Denmark, the so-called two-instance principle applies, thus all cases can be tried in two court instances. Generally, all cases begin in one of the 24 district courts. The district court's ruling can be appealed to one of the two high courts. The high court ruling can only be appealed to the Supreme Court with permission from the Appeals Permission Board.

The oral hearing will begin with the plaintiff presenting the facts and documents of the case. Hereafter, party, witness and expert testimonies are given, and such are subjected to examination/cross-examination. Finally, the parties present their closing statements.

The court will make the decision on the case as soon as possible after the oral hearing, and generally no later than either one or two months following the oral hearing depending on which court the case was tried by.

4.6 Where the contract provides for court proceedings in a foreign country, will the judgment of that foreign court be upheld and enforced in your jurisdiction? If the answer depends on the foreign country in question, are there any foreign countries in respect of which enforcement is more straightforward (whether as a result of international treaties or otherwise)?

In accordance with Chapter III of EU Regulation no. 1215/2012, a court judgment given in another EU Member State will be recognisable and enforceable in Denmark, subject to the limited exceptions provided in article 45. The same applies if the court judgment is given by an EFTA Member State, *cf.* title III of the Lugano Convention.

If the court judgment is given by a country outside the EU and EFTA, the judgment is – as a matter of principle – not recognisable and enforceable in Denmark; however, the foreign judgment can have evidential weight – and in some cases a very high evidential weight – if the case is tried by the Danish courts, *cf.* Gam, Recognition of foreign judgments and arbitral awards under Danish law, *Ugeskrift for Retsvæsen* 2013B, p. 185 *ff.*



Gregers Gam advises Danish and international clients on all matters relating to real estate transactions, construction and commercial law. He advises on large, challenging and complex mandates. He is highly sought after for his expertise in the construction field, where he acts as general counsel servicing a diverse range of clients including, notably, companies with an international presence or ownership. His work also includes advising clients in relation to drafting commercial contracts as well as dispute resolution. Recent highlights include, *inter alia*, advising Copenhagen Metro Team (CMT) on the construction of the new metro line, Cityringen, in Copenhagen – the largest construction project in the past 400 years in Copenhagen.

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1 Making Construction Projects

1.1 What are the standard types of construction contract in your jurisdiction? Do you have: (i) any contracts which place both design and construction obligations upon contractors; (ii) any forms of design-only contract; and/or (iii) any arrangement known as management contracting, with one main managing contractor and with the construction work done by a series of package contractors? (*NB* For ease of reference throughout the chapter, we refer to “construction contracts” as an abbreviation for construction and engineering contracts.)

There are a number of standard forms of construction contract and there are options which require a contractor to:

- build only;
- build and carry out specified elements of design;
- both design and build; or
- assist with design and procurement and manage others to carry out the build.

A contractor can be engaged on a design-only basis, but this is usually before the construction phase.

1.2 How prevalent is collaborative contracting (e.g. alliance contracting and partnering) in your jurisdiction? To the extent applicable, what forms of collaborative contracts are commonly used?

The National Construction Contracts and Law Report 2018 – published by the NBS (originally the National Building Specification) and still the most recent edition as at February 2020 – indicates that partnering/alliancing contracting was used on 3% of the projects respondents were involved with. This compares with: traditional procurement (46%); design and build procurement (41%); construction management (3%); and management contracting (1%).

The Association of Consultant Architects (**ACA**) publishes partnering/alliancing contracts for use on individual projects and for term works. The New Engineering Contract (**NEC**) forms are often used for collaborative projects and the Joint Contracts Tribunal (**JCT**) also publishes the Constructing Excellence contract.

1.3 What industry standard forms of construction contract are most commonly used in your jurisdiction?

The most commonly used are those published by the JCT. The NEC contracts (published by the Institute of Civil Engineers)

are also used, as well as contracts published by: the International Federation of Consulting Engineers (**FIDIC**); the ACA; the Association for Consultancy and Engineering (known as the ICC forms); and the Institute of Chemical Engineers (**ICChemE**), depending on the nature of the work being carried out.

1.4 What (if any) legal requirements are there to create a legally binding contract (e.g. in common law jurisdictions, offer, acceptance, consideration and intention to create legal relations are usually required)? Are there any mandatory law requirements which need to be reflected in a construction contract (e.g. provision for adjudication or any need for the contract to be evidenced in writing)?

All the elements referred to above are required to create a legally binding contract.

The Housing Grants, Construction and Regeneration Act 1996 (as amended) (**HGCRA**) applies to contracts for the carrying out of “construction operations” in England and Wales (subject to certain exceptions). What amounts to “construction operations” is defined in the HGCRA. The HGCRA requires contracts relating to such operations to comply with the minimum requirements. If a contract does not do so, elements of the Scheme for Construction Contracts (the **Scheme**) or the HGCRA will be implied into a contract to make it compliant.

1.5 In your jurisdiction please identify whether there is a concept of what is known as a “letter of intent”, in which an employer can give either a legally binding or non-legally binding indication of willingness either to enter into a contract later or to commit itself to meet certain costs to be incurred by the contractor whether or not a full contract is ever concluded.

There is a concept of a letter of intent. However, the phrase is not a “term of art” and letters of intent can vary considerably, depending on parties’ needs. They can range from: (i) non-binding statements of future intent; to (ii) binding contracts for all or part of the works; to (iii) binding contracts to carry out preliminary steps.

1.6 Are there any statutory or standard types of insurance which it would be commonplace or compulsory to have in place when carrying out construction work? For example, is there employer’s liability insurance for contractors in respect of death and personal injury, or is there a requirement for the contractor to have contractors’ all-risk insurance?

Most businesses have a statutory obligation to maintain the

employer's liability insurance which provides cover for the death of, or personal injury to, employees during the course of employment. Other insurances usually in place include:

- **Public liability insurance:** provides cover in the event of death or personal injury to persons other than employees and loss or damage to third-party property (i.e. other than the works) due to negligence.
- **Professional indemnity insurance:** covers the insured's legal liability if it is negligent and provides cover for defective design, but not defective workmanship or materials.
- **All risks insurance (or works insurance):** covers the risk of loss or damage to the works and any materials on site.
- **Existing structures insurance:** an employer will usually insure any existing structure against loss or damage due to specified perils (i.e. fire, lightning, flooding, etc.).

1.7 Are there any statutory requirements in relation to construction contracts in terms of: (a) labour (i.e. the legal status of those working on site as employees or as self-employed sub-contractors); (b) tax (payment of income tax of employees); and/or (c) health and safety?

The following statutory requirements exist:

- (a) The general rules for establishing the employment status of an individual apply to those working on a construction site.
- (b) The Construction Industry Scheme is a tax deduction scheme which involves the deduction of tax at source from payments under construction contracts (to reduce tax and National Insurance avoidance) if the payee is not registered for gross payment status with HMRC.
- (c) The main pieces of health and safety legislation are:
 - **Health and Safety at Work etc. Act 1974:** sets out the basic health and safety duties of a company, its directors, managers and employees and acts as the framework for other health and safety regulations.
 - **Management of Health and Safety at Work Regulations 1999:** require employers to assess and manage risks which affect their employees and others as a result of the businesses' activities.
 - **Construction (Design and Management) Regulations 2015:** impose specific requirements on those involved in construction projects. This covers the design and construction phases of a project and information to be handed over at the end of a project.

1.8 Is the employer legally permitted to retain part of the purchase price for the works as a retention to be released either in whole or in part when: (a) the works are substantially complete; and/or (b) any agreed defects liability period is complete?

Contractual retentions are common. They usually range from 3–5% of each interim payment. Half is usually released at practical completion and the balance is released once all defects notified in accordance with the contract have been made good. Retention bonds may be accepted as an alternative. Retention use is currently under review by the government and proposals include keeping the *status quo*, banning retentions or introducing a requirement to place retentions in a deposit scheme.

1.9 Is it permissible/common for there to be performance bonds (provided by banks and others) to guarantee the contractor's performance? Are there any restrictions on the nature of such bonds? Are there any grounds on which a call on such bonds may be restrained (e.g. by interim injunction); and, if so, how often is such relief generally granted in your jurisdiction? Would such bonds typically provide for payment on demand (without pre-condition) or only upon default of the contractor?

Performance bonds are common. They are usually guarantees rather than on-demand bonds, which means contractor default is required before a call can be made. The bond may also include a right to make a call if the contractor becomes insolvent. Bondsmen may be able to rely on any defences which the contractor could use to defend a claim by the employer under the construction contract to defend a claim under the bond. Interim injunctions to prevent calls on guarantee bonds are unusual as contractor default is required before a call can be made.

The bonds are generally limited to 10% of the contract sum and expire on or shortly after practical completion (unless a claim has been notified before that date).

1.10 Is it permissible/common for there to be company guarantees provided to guarantee the performance of subsidiary companies? Are there any restrictions on the nature of such guarantees?

It is permissible, and fairly common, for an employer to ask for a parent company guarantee (PCG).

PCGs usually require a breach by the contractor before a claim can be made. In the event of a contractor breach, the guarantor may be required to take over and perform the contractor's obligations and/or be liable for the losses and damages the employer has incurred. The guarantor can usually rely on any defences available to the contractor under the construction contract to defend a claim under the guarantee. The limitation period for bringing a claim tends to be either six or 12 years from the date of contractor breach and the sums recoverable are not usually capped to a percentage of the contract sum.

1.11 Is it possible and/or usual for contractors to have retention of title rights in relation to goods and supplies used in the works? Is it permissible for contractors to claim that, until they have been paid, they retain title and the right to remove goods and materials supplied from the site?

Yes, it is possible for contractors and their supply chain to include retention of title provisions in their contracts. Those provisions are effective as long as the goods or materials have not been incorporated into a building or structure, have not been mixed with other materials or have not been turned into another item (i.e. glue and chippings used to create chipboard). Once any of these things happen or the goods or materials have been paid for, the retention of title provisions are likely to cease to be effective and title will pass to the employer by operation of law.

2 Supervising Construction Contracts

2.1 Is it common for construction contracts to be supervised on behalf of the employer by a third party (e.g. an engineer)? Does any such third party have a duty to act impartially between the contractor and the employer? If so, what is the nature of such duty (e.g. is it absolute or qualified)? What (if any) recourse does a party to a construction contract have in the event that the third party breaches such duty?

Construction contracts are commonly administered by a third party. It is also possible for the employer (or an employee) to supervise/administer a construction contract as long as it is clear in the contract that such person is to fulfil the role.

Appointments of third-party consultants will often include an obligation on the consultant, where it has to exercise discretion between the employer and another party, to do so fairly and impartially. Case law also imposes obligations on those acting in these roles.

The decisions of the third-party certifier can be challenged in accordance with the dispute resolution procedures in the construction contract, but the contractor will not generally have the right to bring a claim directly against the certifier.

2.2 Are employers free to provide in the contract that they will pay the contractor when they, the employer, have themselves been paid; i.e. can the employer include in the contract what is known as a “pay when paid” clause?

The HGCRA makes “pay when paid” clauses ineffective in construction contracts except in situations when the third party paying the employer (or any other person contributing to payment by that third party) is insolvent (as defined in the HGCRA). Some contracts such as certain private finance initiative (PFI) contracts and development agreements with a land transfer are excluded from the remit of the HGCRA and the restriction does not apply.

2.3 Are the parties free to agree in advance a fixed sum (known as liquidated damages) which will be paid by the contractor to the employer in the event of particular breaches, e.g. liquidated damages for late completion? If such arrangements are permitted, are there any restrictions on what can be agreed? E.g. does the sum to be paid have to be a genuine pre-estimate of loss, or can the contractor be bound to pay a sum which is wholly unrelated to the amount of financial loss likely to be suffered by the employer? Will the courts in your jurisdiction ever look to revise an agreed rate of liquidated damages; and, if so, in what circumstances?

Parties are free to agree liquidated damages which will be paid in the event of a breach. They tend to be limited to late completion or failure to meet particular performance requirements. Since 2015, the test for whether liquidated damages are enforceable is whether they impose consequences which are “... out of all proportion to any legitimate interest of the innocent party...”. The fact that a liquidated damages sum does not represent a genuine pre-estimate of loss likely to be suffered by the employer no longer means it will not be enforceable as long as there is a legitimate business interest in the sum being levied.

The courts will not adjust an agreed level of liquidated damages. They will simply consider whether the damages are enforceable or should be struck out as a penalty.

Following a 2019 judgment, contract drafting needs to be clear that liquidated damages for delay can continue to be levied if completion of the works is delayed and the contractor’s employment is terminated before the works are actually completed.

3 Common Issues on Construction Contracts

3.1 Is the employer entitled to vary the works to be performed under the contract? Is there any limit on that right?

Unless the contract expressly permits the employer to vary the works, an employer has no right to do so. Most standard forms, therefore, include a contractual right for the works to be varied by the employer or by the party administering the contract. Variations are usually given by written instruction and if the works are varied the contractor will usually (unless the variation is required because of contractor breach) have grounds to claim additional time and money for the variation.

3.2 Can work be omitted from the contract? If it is omitted, can the employer carry out the omitted work himself or procure a third party to perform it?

The employer may only omit work if the construction contract expressly permits this. Contracts usually allow an employer to omit works and for an adjustment to be made to the contract sum. If work is otherwise omitted, it will amount to a breach of contract. Whether an employer can carry out omitted work or procure a third party to do so depends on the contract drafting. Most standard form construction contracts do not expressly deal with this. The contractor may still be entitled to be paid the profit it would otherwise have earned on the part of the works omitted.

3.3 Are there terms which will/can be implied into a construction contract (e.g. a fitness for purpose obligation, or duty to act in good faith)?

Terms may be implied by statute, a course of dealings, industry practice or by case law, e.g.:

- If a contract does not include a “substantial remedy” for late payment, a statutory rate of interest will be implied.
- If a contract is silent on issues such as price, quality and timing, the Supply of Goods and Services Act 1982 (as amended) may imply terms.
- If a contractor designs and builds a project and the contract does not clarify the level of skill and care required, there may be an implied fitness for purpose obligation. It is difficult to insure such an obligation and so most construction contracts include an express requirement that the contractor will exercise reasonable skill and care in the design.

The courts are unwilling to imply a duty of good faith into contracts (including construction contracts) between commercial parties. There has been a slight shift in position recently (in relation to long-term “relational” contracts) but decisions from 2019 cast doubt on whether this trend will continue. Notwithstanding this, where there is an element of discretion when making a decision under a contract, there may be an implied term that the discretion will be exercised in good faith.

3.4 If the contractor is delayed by two concurrent events, one the fault of the contractor and one the fault or risk of his employer, is the contractor entitled to: (a) an extension of time; and/or (b) the costs arising from that concurrent delay?

It depends on the way in which the contract is written. If an un-amended JCT construction contract is used, then based on current case law, the contractor will be entitled to an extension of time in the event of concurrent delay, but not to recover its associated delay costs. Parties are free to change the way in which concurrency is dealt with in a contract and the Court of Appeal has recently upheld a clause which shifted the risk of concurrency from the employer to the contractor.

3.5 Is there a time limit beyond which the parties to a construction contract may no longer bring claims against each other? How long is that period and when does time start to run?

The statutory limitation period for a breach of contract claim is six years unless the contract is entered into as a deed, in which case it is 12 years. Time typically starts to run from the date of practical completion. Statutory limitation periods can be shortened contractually and it is possible to extend the statutory limitation period provided that very clear wording is used.

There are statutory time limits for bringing a claim in tort (but the ability to bring a claim in tort on construction projects is limited).

3.6 Which party usually bears the risk of unforeseen ground conditions under construction contracts in your jurisdiction?

If the construction contract is silent, it is the contractor. Some standard form construction contracts alter this by making the contractor responsible for ground conditions unless something is encountered which an experienced and competent contractor could not have reasonably foreseen at the date of tender.

3.7 Which party usually bears the risk of a change in law affecting the completion of the works under construction contracts in your jurisdiction?

If the construction contract is silent, it is the contractor. Some standard forms change this so that the contractor is responsible unless the change was not reasonably foreseeable at the date of tender.

3.8 Which party usually owns the intellectual property in relation to the design and operation of the property?

Copyright vests in the author of the copyright material. It is possible to assign copyright but this is unusual. More often, the copyright owner will grant an irrevocable and royalty-free licence to use and reproduce the copyright material to the employer and third parties such as purchasers, tenants, funders and landlords. The licence usually allows sub-licensing.

3.9 Is the contractor ever entitled to suspend works?

The HGCRA includes a statutory right for a contractor to suspend performance of any or all of its obligations in the event

of non-payment provided that it gives at least seven days' notice of its intention to do so. Other than this, a contractor cannot suspend the works unless there is a contract right (which is highly unusual).

3.10 Are there any grounds which automatically or usually entitle a party to terminate the contract? Are there any legal requirements as to how the terminating party's grounds for termination must be set out (e.g. in a termination notice)?

A party is entitled to terminate a contract if the other party commits a repudiatory breach.

Construction contracts also usually include contractual grounds for termination; for example: insolvency of either party; bribery or corruption by either party; failure to comply with instructions by the contractor; failure to proceed regularly and diligently with the works by the contractor; the employer not paying on time; or the contractor suspending the works without good reason. Contractual rights have to be exercised in accordance with the timescales and notice requirements in the relevant contract.

3.11 Do construction contracts in your jurisdiction commonly provide that the employer can terminate at any time and for any reason? If so, would an employer exercising that right need to pay the contractor's profit on the part of the works that remains unperformed as at termination?

Standard form construction contracts do not generally allow this. It is possible (but not usual) to include a bespoke term allowing an employer to terminate at will. Whether an employer would be liable for loss of profit in those circumstances depends upon the terms of the contract.

3.12 Is the concept of *force majeure* or frustration known in your jurisdiction? What remedy does this give the affected party? Is it usual/possible to argue successfully that a contract which has become uneconomic is grounds for a claim for *force majeure*?

Force majeure has no particular meaning in England. Despite this, construction contracts may refer to *force majeure*, which can prove problematic as there is no clarity about what is covered. Elements of what might be considered *force majeure* (i.e. adverse weather, lightning strike, flood and civil commotion) may be listed as express grounds allowing a contractor to claim additional time and/or money and may also be grounds for suspension (and termination if suspension lasts longer than a pre-agreed period). The fact that a contract has become uneconomic is not generally a ground to claim *force majeure*. The meaning of *force majeure* under English law is likely to be given close attention in the context of the current COVID-19 global pandemic.

Frustration is recognised in England. If a contract is "frustrated", it will be automatically discharged. The contract is effectively brought to an end without the parties having to do anything and the parties are excused from performing any more obligations under the contract (although, if a party incurred obligations before the contract was frustrated, it still has to perform those). Parties cannot claim damages for future non-performance by the other(s).

3.13 Are parties, who are not parties to the contract, entitled to claim the benefit of any contractual right which is made for their benefit? E.g. is the second or subsequent owner of a building able to claim against the contractor pursuant to the original construction contracts in relation to defects in the building?

The Contracts (Rights of Third Parties) Act 1999 (**C(ROTP)A**) provides that a third party can enforce a term/benefit of a contract if the contract expressly provides that it may do so or the term(s) purport(s) to confer a benefit on it (and there is nothing in the contract to suggest that the parties did not intend the third party to be able to enforce that term). The third party can be identified by name, by membership of a “class” or group (i.e. tenants of the development) or by reference to a particular description. They do not have to be in existence at the time that the construction contract is entered into.

3.14 On construction and engineering projects in your jurisdiction, how common is the use of direct agreements or collateral warranties (i.e. agreements between the contractor and parties other than the employer with an interest in the project, e.g. funders, other stakeholders, and forward purchasers)?

Collateral warranties are commonly used. It is a separate contract between a contractor and a third party in which the contractor warrants that it has performed and will continue to perform its obligations under the construction contract; agrees to maintain insurance; and grants a copyright licence and, in some instances, agrees to step-in rights (amongst other things).

3.15 Can one party (P1) to a construction contract, who owes money to the other (P2), set off against the sums due to P2 the sums P2 owes to P1? Are there any limits on the rights of set-off?

There are various rights of set-off including legal set-off, equitable set-off, contractual set-off and statutory/insolvency set-off. P1 can potentially set off sums which P2 owes to it from sums which P1 owes to P2 under the rules of equitable set-off and possibly under any contractual rights of set-off. P1 may need to comply with the notice requirements under the HGCRA and (if contractual set-off rights are being relied upon) any contractual notice requirements.

3.16 Do parties to construction contracts owe a duty of care to each other either in contract or under any other legal doctrine? If the duty of care is extra-contractual, can such duty exist concurrently with any contractual obligations and liabilities?

Construction contracts generally contain an obligation on the contractor to carry out the works in accordance with the contract and, if the contractor is carrying out design, to do so using reasonable skill and care.

If there is no contract, a contractor may owe a tortious duty of care to an employer to avoid causing personal injury and not to cause loss or damage to property other than the works. Case law restricts an employer’s ability to recover in tort for defects and damage to the works or the property constructed as part of the works itself.

A contractor may, in limited circumstances, owe a tortious duty of care to an employer in addition to any obligations under the contract with the employer.

3.17 Where the terms of a construction contract are ambiguous, are there rules which will settle how that ambiguity is interpreted?

The court will:

- look at the contract as a whole rather than the clause/drafting in isolation;
- apply, in the absence of ambiguity, the natural and ordinary meaning of the clause – the worse the drafting, the more readily the court will accept a meaning other than its natural one;
- take into account the facts and circumstances known to the parties at the time the contract was concluded;
- take into account commercial common sense; and
- not impose its own view of what the parties should have reasonably agreed when the literal meaning is clear.

3.18 Are there any terms which, if included in a construction contract, would be unenforceable?

Yes:

- A “pay when paid” clause if the third-party payer is not insolvent (as defined in the HGCRA) and the construction contract is not excluded from the HGCRA definition of a contract for the carrying out of “construction operations”.
- A penalty clause.
- An indemnity against criminal liability.
- A clause which allocates adjudication costs between the parties before adjudication is commenced, except in certain circumstances.

3.19 Where the construction contract involves an element of design and/or the contract is one for design only, are the designer’s obligations absolute or are there limits on the extent of his liability? In particular, does the designer have to give an absolute guarantee in respect of his work?

Design-only contracts

Common law and statute mean a designer is only liable if its conduct falls below the standard of an ordinary and competent consultant of their profession. Contracts generally impose a higher requirement – to exercise the reasonable skill and care to be expected of a consultant experienced in providing services similar to the services the consultant is retained to complete on similar projects. Fitness for purpose obligations (i.e. an absolute guarantee) are unusual.

Design and build contracts

If a contractor designs and builds a project and there is no contractual skill and care requirement, there may be an implied fitness for purpose obligation (i.e. an absolute guarantee in respect of the works). However, it is difficult to insure and construction contracts tend to include a contractual skill and care provision. In 2017, the Supreme Court confirmed that a construction contract can include a mix of obligations – reasonable skill and care, and an absolute requirement in relation to particular elements.

3.20 Does the concept of decennial liability apply in your jurisdiction? If so, what is the nature of such liability and what is the scope of its application?

There is no concept of decennial liability in England.

4 Dispute Resolution

4.1 How are construction disputes generally resolved?

By adjudication, litigation and arbitration. Parties may also use mediation during the course of litigation or arbitration proceedings to try to resolve disputes and this is actively encouraged by the courts.

4.2 Do you have adjudication processes in your jurisdiction (whether statutory or otherwise) or any other forms of interim dispute resolution (e.g. a dispute review board)? If so, please describe the general procedures.

Parties to a “construction contract”, as defined in the HGCRA (subject to some exceptions), have a statutory right to refer a dispute “under or in connection” with that contract to adjudication at any time.

An adjudicator should be appointed within seven days of a party being notified that a dispute is being referred to adjudication. The adjudicator has 28 days to reach a decision, which can be extended in certain circumstances.

An adjudicator’s decision is binding until the dispute is finally determined by arbitration, litigation or agreement between the parties. The successful party can apply to court to enforce an adjudicator’s decision if the other party does not comply with it. The grounds for challenging an adjudicator’s decision and/or asking for a stay of enforcement are very limited.

If a contract is not a “construction contract” for the purposes of the HGCRA, the parties are free to include a contractual adjudication mechanism (which tend to follow the requirements of the HGCRA).

There are no other statutory forms of interim dispute resolution. The popularity of adjudication makes it rare for parties to create other forms of interim dispute resolution in their contracts.

4.3 Do the construction contracts in your jurisdiction commonly have arbitration clauses? If so, please explain how, in general terms, arbitration works in your jurisdiction.

Construction contracts in England do not tend to include arbitration clauses and it is rare for parties to agree to refer disputes to arbitration. This is because the Technology and Construction Court (TCC) is considered to provide high-quality decisions more quickly and cost-effectively than arbitration. However, arbitration is still a popular choice for large international projects.

Arbitration is governed by the Arbitration Act 1996, which allows parties the freedom to choose the number and identity of arbitrators and the applicable rules. The English courts are very supportive of arbitration and arbitration clauses are enforced; the grounds on which decisions can be challenged are limited and successful challenges are very rare.

4.4 Where the contract provides for international arbitration, do your jurisdiction’s courts recognise and enforce international arbitration awards? Please advise of any obstacles (legal or practical) to enforcement.

The UK is a signatory to the New York Convention and English courts will enforce awards made by arbitral tribunals which have

their seats in other signatory states. This is subject only to a discretion to refuse enforcement on the grounds set out in the New York Convention.

English courts are generally regarded as being supportive of the arbitral process and this is reflected in their approach to the public policy ground for refusing enforcement under the New York Convention. A party seeking to resist enforcement on this ground will normally need to prove fraud, corruption or some other “universally condemned” activity (i.e. terrorism or drug trafficking).

4.5 Where a contract provides for court proceedings in your jurisdiction, please outline the process adopted, any rights of appeal and a general assessment of how long proceedings are likely to take to reduce: (a) a decision by the court of first jurisdiction; and (b) a decision by the final court of appeal.

Construction claims are usually dealt with by the TCC, with smaller and less complex claims being dealt with in County Courts.

Before commencing proceedings, parties have to engage in the Pre-Action Protocol for Construction and Engineering Disputes. Parties set out their respective positions in correspondence and then meet on a “without prejudice” basis (unless there is a good reason not to) to identify the main issues in dispute, consider how the dispute might be resolved without litigation and, if litigation is inevitable, how it can be managed cost-effectively. The process is designed to be completed within 49–105 days.

Proceedings in the TCC are governed by the Civil Procedure Rules and the Technology and Construction Court Guide.

The following procedure is generally adopted:

- the claimant issues a claim form and particulars of claim;
- the defendant serves its defence and any counterclaim;
- the court holds a case management conference during which it sets out what the parties, their representatives and experts need to do and by when; and
- there is a trial, following which the judge gives written judgment.

The process usually takes 10–18 months (depending on the case’s complexity and court availability).

Parties can apply for permission to appeal from the High Court to the Court of Appeal and from the Court of Appeal to the Supreme Court, but it is not often given. Where it is, it can take around a further year to obtain a decision from the Court of Appeal and a further year to obtain a decision from the Supreme Court. Again, this depends on the complexity and importance of the case and court availability.

4.6 Where the contract provides for court proceedings in a foreign country, will the judgment of that foreign court be upheld and enforced in your jurisdiction? If the answer depends on the foreign country in question, are there any foreign countries in respect of which enforcement is more straightforward (whether as a result of international treaties or otherwise)?

Until 31 December 2020 (i.e. during the transition period when the UK remains subject to EU law), judgments of EU and EFTA states (except Liechtenstein) will be enforced in England in accordance with the Recast Brussels Regulation and the 2007 Lugano Convention, respectively.

On leaving the EU, the UK will become a party to the Hague Convention on Choice of Court Agreements (the **Hague Convention**) in its own right. The Hague Convention requires contracting states (currently all EU Member States, Mexico, Singapore and Montenegro) to recognise exclusive choice of court agreements in favour of other contracting states and to enforce any resulting judgments.

The UK also has bilateral arrangements for the reciprocal enforcement of judgments with a number of other countries (predominantly Commonwealth countries).

Where none of the above applies, a party seeking to enforce a foreign judgment has to issue fresh proceedings in England to recover the judgment sum as a debt.



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On the non-contentious side, we advise on procurement strategies, development agreements, building contracts, professional appointments, warranties, third-party rights, guarantees and bonds, risk and project management and dispute avoidance. We advise on all forms of procurement, from design and build, through to traditional construction management.

Our work often involves working hand in hand with the firm's real estate, finance, tax and corporate lawyers and we always ensure that our advice is delivered in the context of the wider transaction and the commercial drivers

behind it. Our dedicated construction litigators are able to offer strategic and tactical advice to best protect our clients in the event of a dispute arising. They advise on all forms of dispute resolution, including litigation, arbitration, adjudication and mediation.

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1 Making Construction Projects

1.1 What are the standard types of construction contract in your jurisdiction? Do you have: (i) any contracts which place both design and construction obligations upon contractors; (ii) any forms of design-only contract; and/or (iii) any arrangement known as management contracting, with one main managing contractor and with the construction work done by a series of package contractors? (NB For ease of reference throughout the chapter, we refer to “construction contracts” as an abbreviation for construction and engineering contracts.)

The most common type of construction contract in the private sector is the *contrat d'entreprise* (construction contract) which typically requires the contractor to deliver a complete and fit-for-purpose project and imposes an obligation to advise and inform the *maître d'ouvrage* (the employer) and the *maître d'oeuvre* (design and management team).

Other contracts commonly encountered in the private sector are: (i) the *contrat de promotion immobilière* (real estate development agreement) by which the employer entrusts a developer with the performance of a defined construction programme for a fixed price and completion date; and (ii) *vente en l'état future d'achèvement* (off-plan property sales) by which the *maître d'ouvrage* (the employer) finances the project by sales made prior to completion.

In the public sector, construction contracts are strictly regulated. The most common types of contracts are: (i) *marché public de travaux* (public works contract); (ii) *contrat de concession* (concession contract); and (iii) *partenariat public-privé* (PPP) (public-private partnership).

Design, project management and construction services are typically procured under separate contracts. Design and project management services are usually provided by the *maître d'oeuvre* (an architect or engineering firm) under a *contrat de maîtrise d'oeuvre* (design and project management contract), while the contractor is in charge of construction. It is less common for design and construction to be entrusted to the same entity but this does occur (for example, pursuant to a *marché de conception-réalisation* or design-build public contract).

While *maîtrise d'oeuvre* covers both *maîtrise d'oeuvre de conception* (design) and *maîtrise d'oeuvre de réalisation* (project management), those disciplines may be contracted separately.

Contracts for “management contracting” are uncommon in France. A *maître d'oeuvre* is usually in charge of supervising the works and coordinating the various contractors, but does not assume responsibility for the timely completion of the works or cost overruns (other than by way of bonus or penalty incentives).

Employers can, however, contract: (i) with multiple contractors separately; (ii) with an *entreprise générale* (general contractor) who subcontracts certain work packages; or (iii) with a group of contractors led by a main contractor in charge of coordinating the works (usually the contractor with the largest work package). In practical terms, the two latter scenarios are comparable to management contracting.

1.2 How prevalent is collaborative contracting (e.g. alliance contracting and partnering) in your jurisdiction? To the extent applicable, what forms of collaborative contracts are commonly used?

In France, traditional approaches to risk allocation are generally preferred and collaborative contracting methods are not widely used. This is particularly true in the public sector where procurement processes and contracts are heavily regulated in ways that do not lend themselves to collaborative contracting. For example, the Public Procurement Code (*Code de la Commande Publique* or CCP) contemplates only *prix forfaitaires* (lump-sum) and *prix unitaires* (bill of quantities) arrangements.

There is, however, a nascent trend towards using collaborative contracts for international projects in the private sector. While these agreements are often bespoke, Joint Contracts Tribunals (JCT) contracts and New Engineering Contracts (NEC) are sometimes used as a model.

1.3 What industry standard forms of construction contract are most commonly used in your jurisdiction?

In both the private and public sectors, construction contracts are generally bespoke but are often inspired by standard forms.

In the private sector, the most commonly used standard forms are those published by AFNOR (the French Standardization Association). For example, AFNOR norm NF P03-001 applies to building works and norm NF P03-002 to civil works.

In the public sector, contracts typically derive from the *Cahiers des Clauses Administratives Générales* (CCAG), which provide general terms and conditions for public works contracts. The provisions of the CCAG, which are no longer mandatory, are regularly updated by public authorities.

For large-scale international projects, FIDIC standard forms are often relied upon; most commonly the Red Book (construction works), Yellow Book (design-build) and Silver Book (EPC/turnkey contracts). The FIDIC standard forms require adaptation to align with relevant mandatory provisions of French law (e.g., relating to subcontractor payments and subcontractors' ability to claim payment directly from the employer).

1.4 What (if any) legal requirements are there to create a legally binding contract (e.g. in common law jurisdictions, offer, acceptance, consideration and intention to create legal relations are usually required)? Are there any mandatory law requirements which need to be reflected in a construction contract (e.g. provision for adjudication or any need for the contract to be evidenced in writing)?

In the private sector, parties are in principle free to determine the content and form of their contracts, subject to mandatory provisions of French law. Contracts are made by the mere exchange of the parties' consent, and, in principle, verbal offer and acceptance are sufficient as a matter of form. This is subject to certain exceptions (notably those involving consumers) – e.g., *contrat de promotion immobilière* (real estate development agreements) and *vente en l'état future d'achèvement* (VEFA) (off-plan sale) (see question 1.1).

In the public sector, contracts are heavily regulated. They must be in writing and their content compliant with national and European public procurement rules. Rather than invalidating a non-compliant contract, French courts may deem mandatory rules to have been incorporated where the parties have failed to do so expressly or ignore non-compliant provisions.

1.5 In your jurisdiction please identify whether there is a concept of what is known as a "letter of intent", in which an employer can give either a legally binding or non-legally binding indication of willingness either to enter into a contract later or to commit itself to meet certain costs to be incurred by the contractor whether or not a full contract is ever concluded.

Letters of intent are used in the private sector. Letters of intent do not, however, enjoy codified status and their form is not regulated. In principle, letters of intent are not binding and do not give rise to contractual obligations.

However, where the letter of intent sets out the key terms of the bargain (e.g., parties, price and conditions precedent) and it is clear that the parties intend to be bound by it, a letter of intent may constitute a binding agreement notwithstanding that some terms remain to be agreed.

Even where a letter of intent does not give rise to contractual obligations, the undertaking of negotiations attracts the obligation to conduct them in good faith. Abruptly terminating negotiations may therefore give rise to liability for the other party's reliance losses (i.e., wasted costs and expenses) but not its expectation losses (i.e., lost profits or loss of opportunity).

1.6 Are there any statutory or standard types of insurance which it would be commonplace or compulsory to have in place when carrying out construction work? For example, is there employer's liability insurance for contractors in respect of death and personal injury, or is there a requirement for the contractor to have contractors' all-risk insurance?

The two main types of insurance that are compulsory relate to decennial liability (i.e., unfitness for purpose and structural damages occurring within 10 years after taking over – see question 3.20). Both the employer and the contractor must subscribe to such insurance (known as *assurance dommage ouvrage* for the employer and *assurance responsabilité décennale* for the contractor). Although rare in practice, these two insurances can be merged into a single policy known as a *police unique de chantier*.

Other compulsory insurance include *assurance de responsabilité civile professionnelle* (professional liability insurance) for some construction professionals (e.g., architects).

Standard non-compulsory insurance policies include: (i) *assurance responsabilité civile* (third-party liability); (ii) *assurance tous risques chantier* (construction all-risk insurance); and (iii) subcontractors' decennial liability insurance. The requirement to have such insurance in place is typically governed by contract.

1.7 Are there any statutory requirements in relation to construction contracts in terms of: (a) labour (i.e. the legal status of those working on site as employees or as self-employed sub-contractors); (b) tax (payment of income tax of employees); and/or (c) health and safety?

Labour and health and safety matters are heavily regulated in France and on-site inspections are conducted on a regular basis by authorities.

In France, the Labour Code contains strict provisions in relation to employment contracts – e.g., the type and content of the contract, working conditions, dismissal. There are, however, no specific requirements in relation to the construction sector insofar as the employer/employee relationship is concerned. Employers must submit a declaration of employment to the social security agency in respect of each employee prior to the start of the employment and failing to do so may result in financial and criminal sanctions. Non-EU foreign workers must generally obtain work and residence permits, unless they already hold permits allowing them to work in France – e.g., a *carte de résident* (resident card).

Collective agreements supplement general labour law in certain sectors, including the construction sector.

Although not specific to the construction sector, France now operates a pay-as-you-earn system for income tax, under which employers are required to collect and remit income tax on employees' salaries.

Health and safety requirements in the construction industry are primarily found in the Labour Code, which notably implements European directives no. 89/391 and no. 92/57. These requirements apply to all the parties involved in a construction project (employers, contractors, consultants, etc.).

There are two main sets of requirements. First, employers have a general safety obligation. They must take all necessary steps to ensure safety and protect the health of their employees through preventive actions, information and training. Second, project owners must: (i) appoint a *coordonateur sécurité-protection-santé* (health and safety coordinator) in charge of monitoring and managing health and safety risks; (ii) ensure that this coordinator prepares and maintains a health and safety plan until completion of the project; and (iii) ensure that this coordinator prepares a *dossier d'intervention ultérieure sur l'ouvrage* which addresses health and safety risks during the subsequent maintenance phase.

Violations of health and safety requirements can result in criminal penalties.

1.8 Is the employer legally permitted to retain part of the purchase price for the works as a retention to be released either in whole or in part when: (a) the works are substantially complete; and/or (b) any agreed defects liability period is complete?

Retention provisions are permitted under French law. The principal purpose of the retention is usually to cover the remediation of defects during the defects liability period (typically one year after take-over). However, the release of retention monies may also be tied to the completion of the works.

Subject to a few exceptions (e.g., in the defence industry), retention provisions are limited by law to 5% of the contract price and contractors have the option to replace them by bank guarantees (*cautions solidaires*) of the equivalent amount. Despite this cap, however, it is not uncommon to see parties agree higher amounts for retentions (or replacement bank guarantees) in their contracts.

1.9 Is it permissible/common for there to be performance bonds (provided by banks and others) to guarantee the contractor's performance? Are there any restrictions on the nature of such bonds? Are there any grounds on which a call on such bonds may be restrained (e.g. by interim injunction); and, if so, how often is such relief generally granted in your jurisdiction? Would such bonds typically provide for payment on demand (without pre-condition) or only upon default of the contractor?

In the private sector, performance bonds guaranteeing the contractor's performance are common. The form of such bonds is a matter for the parties but they most frequently take the form of a *garantie autonome* (on-demand guarantee) or a *cautionnement* (i.e., a personal surety by which the *caution* undertakes to perform the debtor's obligation if the debtor fails to perform it himself). If a *cautionnement* is given, the *caution* is broadly in a position of joint and several liability with the contractor.

On-demand guarantees are autonomous from the underlying construction contract and calls upon them may only be opposed in the event of fraud or an abusive call by the beneficiary. Under a *cautionnement*, the *caution* may resist payment or performance on the same grounds as the contractor, except those which are purely personal to the contractor (e.g., a defect in consent that results in the nullity of the underlying contract).

In the private sector, it is not uncommon for performance bonds to exceed 5% of the contract price.

In the public sector, the applicable procurement rules do not contemplate the provision of performance bonds by contractors but they are sought in practice. Public authorities seldom seek performance bonds in excess of 5% of the contract price.

1.10 Is it permissible/common for there to be company guarantees provided to guarantee the performance of subsidiary companies? Are there any restrictions on the nature of such guarantees?

Parent company guarantees are permitted in France and are common in the private sector. Such guarantees may take the form of a *garantie autonome* (on-demand guarantees), *cautionnement* (see question 1.9) or *lettre d'intention* (comfort letter).

Parent company guarantees are not commonly seen in the public sector, where procurement processes provide sufficient comfort as to the financial wherewithal of the successful candidate.

1.11 Is it possible and/or usual for contractors to have retention of title rights in relation to goods and supplies used in the works? Is it permissible for contractors to claim that, until they have been paid, they retain title and the right to remove goods and materials supplied from the site?

It is possible but very uncommon for contractors to have retention of title rights in relation to goods and supplies used in the works.

Unlike a sales contract, *contrats d'entreprise* (see question 1.1) do not transfer ownership at the time of contract formation. Equipment and materials used in the works become the property of the employer as and when they are incorporated into the works.

Retention of title is possible in respect of goods and supplies not yet incorporated into the building or which can be removed without damaging the building.

By exception, certain contracts also provide that the contractor will remain the owner of the work until full payment is effected – e.g., the model works contract of the *Office Général du Bâtiment et des Travaux Publics* (OGBTP). However, the validity of such clauses is debated and they are not enforceable against third parties.

2 Supervising Construction Contracts

2.1 Is it common for construction contracts to be supervised on behalf of the employer by a third party (e.g. an engineer)? Does any such third party have a duty to act impartially between the contractor and the employer? If so, what is the nature of such duty (e.g. is it absolute or qualified)? What (if any) recourse does a party to a construction contract have in the event that the third party breaches such duty?

The role of the *maître d'oeuvre* (see question 1.1) is comparable to that of an engineer. The *maître d'oeuvre* supervises the works and coordinates the various work-package contractors engaged by the employer. The *maître d'oeuvre* acts on behalf of the employer and is not required to act impartially. However, the *maître d'oeuvre* (typically an architect or engineering company) may be prevented from acting solely in the employer's interests where doing so would contravene professional conduct rules.

The rights and obligations of the *maître d'oeuvre vis-à-vis* the contractor are usually set out in the contract concluded with the employer. A breach of an obligation of the *maître d'oeuvre* is deemed to be a contractual breach of the employer, who may in turn seek compensation from the *maître d'oeuvre*.

2.2 Are employers free to provide in the contract that they will pay the contractor when they, the employer, have themselves been paid; i.e. can the employer include in the contract what is known as a "pay when paid" clause?

"Pay when paid" clauses are permitted between employers and contractors in France and are primarily used in the project finance context (although not typically in respect of the agreed contract price).

In the private sector, "pay when paid" clauses will be ineffective as against subcontractors. Mandatory provisions of French law governing subcontracting provide that subcontractors can seek payment directly from the employer and contractors are required to either delegate payment of the subcontractors to the employer or provide a bond guaranteeing subcontractor payments. In the public sector, subcontractors are generally paid directly by the employer.

2.3 Are the parties free to agree in advance a fixed sum (known as liquidated damages) which will be paid by the contractor to the employer in the event of particular breaches, e.g. liquidated damages for late completion? If such arrangements are permitted, are there any restrictions on what can be agreed? E.g. does the sum to be paid have to be a genuine pre-estimate of loss, or can the contractor be bound to pay a sum which is wholly unrelated to the amount of financial loss likely to be suffered by the employer? Will the courts in your jurisdiction ever look to revise an agreed rate of liquidated damages; and, if so, in what circumstances?

Pénalités (liquidated damages) are permitted and common in France. Delay liquidated damages are particularly prevalent but *clauses pénales* (liquidated damages clauses) may apply to other contractual violations (e.g., failure to achieve agreed plant capacity).

Unless specifically agreed, liquidated damages are not exclusive of other remedies and may thus serve a purely punitive function. Liquidated damages therefore do not need to reflect a genuine pre-estimate of loss and may be due to the employer irrespective of whether the actual loss suffered is equivalent to the liquidated damages amount.

French courts may revise the liquidated damages payable when they are manifestly excessive or derisory relative to actual loss suffered and the overall value of the contract. Parties cannot exclude the courts' intervention by contract; it is, in practice, a power that is rarely exercised.

3 Common Issues on Construction Contracts

3.1 Is the employer entitled to vary the works to be performed under the contract? Is there any limit on that right?

In the public sector, the employer has a special prerogative (*prérogative de puissance publique*) entitling it to vary the terms of the contract unilaterally, provided the conditions set out in the CCP are met. This right is subject to certain limits developed by case law, some of which have been codified in the CCP. For example, the employer is not entitled to vary the financial terms of the contract, change the overall nature of the contract or substantially alter its terms (i.e., a *modification essentielle des conditions*), or require the execution of additional works foreign to the object of the contract. The parties may also agree to limit this right by contract (e.g., Article 15.2.2 of the CCAG entitles the contractor to refuse a variation that increases the price of the works by more than 10% of the contract price).

In the private sector, the general principle is that contracts can only be varied with the parties' mutual consent or for reasons expressly authorised by law (e.g., under the *théorie de l'imprévision* or hardship doctrine). In practice, however, private construction contracts often include provisions entitling the employer to issue variation orders. For example, the contracts which use the form NF P 03-001 issued by AFNOR provide for the possibility to vary the works (Article 11).

3.2 Can work be omitted from the contract? If it is omitted, can the employer carry out the omitted work himself or procure a third party to perform it?

The employer may omit work from the contract as part of its right – unilateral for public contracts and contractual for private

contracts – to vary the terms of the contract (see question 3.1). This right is subject to the same limits as the right to instruct a positive variation and generally entitles the contractor to compensation, subject to any countervailing contractual provisions. For example, in the public sector, the contractor may only be entitled to receive compensation if the reduction of the value of the omitted works is more than 5% of the contract price for a lump-sum contract and 20% of the contract price in a measurement contract (CCAG, Article 16).

The contractor, on the other hand, may not omit any part of the work without the employer's consent. Such omission would otherwise constitute breach of the contract. If the contractor refuses to carry out the omitted work, the employer may refuse takeover, terminate the contract and claim damages. The employer may also, subject to certain requirements, carry out the omitted work himself or procure a third party to perform it, and require the contractor, who failed to perform, to advance the necessary sums for the work.

3.3 Are there terms which will/can be implied into a construction contract (e.g. a fitness for purpose obligation, or duty to act in good faith)?

As a general principle, the parties must comply not only with the explicit terms of the contract, but also with all terms implied by equity, customs or the law (Civil Code, Article 1194). An example of such an implied term is the contractor's *obligation de conseil* (duty of advice), which obliges the contractor to inform himself of all information relevant to the work (including its intended use) and to advise the employer of certain risks.

Lois de police or *règles d'ordre public* (mandatory rules of law) cannot be excluded and will thus also be implied into construction contracts. The obligation to act in good faith is an example of a mandatory rule that cannot be excluded or modified by agreement. It governs the negotiation, conclusion and performance of the contract (Civil Code, Article 1104). Other examples of mandatory rules include those relating to subcontracting, liability and insurance, on employer's retention and payment guarantees and statutory warranty regimes (see question 3.5).

The fitness for purpose obligation is a term implied by law, which cannot not be excluded by agreement. The contractor's *ouvrage* (works) must not be *impropre à sa destination* (unfit for its purpose) (Civil Code, Article 1792). The fitness for purpose obligation covers a wide range of defects and is the subject of abundant case law.

3.4 If the contractor is delayed by two concurrent events, one the fault of the contractor and one the fault or risk of his employer, is the contractor entitled to: (a) an extension of time; and/or (b) the costs arising from that concurrent delay?

In French law, there is no established set of rules on concurrent delay and its effects as to the contractor's entitlement to an extension of time and costs.

In principle, the contractor is under an *obligation de résultat* (absolute obligation), as opposed to an *obligation de moyens* (obligation of means), to complete the works by the contractual deadline. If delay occurs, the contractor may be liable and subject to penalties unless it can prove that the delay is due to causes outside its contractual sphere of responsibility, including employer delays.

In the event of concurrent employer delays, a French court would typically seek to apportion the liability for the delay as between the delay events caused by the employer and those

caused by the contractor. The analysis is highly fact-sensitive and is conducted as part of the *appréciation souveraine des juges du fond* (the court's sovereign appreciation). The contractor would usually be granted an extension of time and compensation in respect of the delays attributed to the employer.

3.5 Is there a time limit beyond which the parties to a construction contract may no longer bring claims against each other? How long is that period and when does time start to run?

There are a number of limitation periods that may apply, subject to the nature of the claim brought.

There are three specific limitation periods that apply to employer claims in the construction context. These are the *garantie de parfait achèvement* (one-year warranty) covering all defects indicated by the employer during the first year after the handover (Civil Code, Article 1792-6), the *garantie biennale* (two-year warranty) covering all defects affecting separable equipment (Code Civil, Article 1792-3) and the *garantie décennale* (10-year warranty) covering all defects that compromise the stability of the work or the equipment forming part thereof, or rendering it unfit for its purpose (Civil Code, Article 1792, 1792-2). These limitation periods run from the date the work has been handed over to the employer (*la réception*) (Civil Code, Article 1792-4-1).

Otherwise, the *prescription de droit commun* (general limitation period) applies to employer and contractor claims. That period is five years from the date on which the right holder knows, or ought to have known, the facts giving rise to the claim (Civil Code, Article 2224). Parties may agree to extend or shorten the limitation period, albeit to no less than one year and no more than 10 years.

In the public sector, payment claims against the State, *départements*, *communes* and *établissements publics* are subject to specific procedural requirements and must be brought within a four-year limitation period, starting from the first day of the year following the year in which the rights were acquired. If used, the CCAG also include a specific set of limitation periods within which contractors must bring claims.

3.6 Which party usually bears the risk of unforeseen ground conditions under construction contracts in your jurisdiction?

The allocation of risk for unforeseen ground conditions is not regulated by mandatory rules and is thus a matter for agreement between the parties. Contractual provisions allocating the risk to one party or another are, in principle, valid. In practice, contracts in the private and public sectors typically allocate the risk to the contractor.

Absent an express contractual allocation of risk, contractors in the public sector may resort to the *théorie des sujétions imprévues*. This principle entitles the contractor, under certain conditions, to full compensation for the loss caused by unforeseen ground conditions, including the costs of additional works.

Until recently, there was no equivalent principle in the private sector. However, the Civil Code provides a remedy in case of *imprévision* (or hardship). This principle may apply when there is a change of circumstances, unforeseen at the time of the conclusion of the contract, that makes performance of the contract excessively onerous for one of the parties, who had not assumed the risk. Where its requirements are satisfied, a party may seek to renegotiate the terms of the contract or agree to terminate it. In the absence of agreement, either party may, within a reasonable time, apply to the courts to revise or terminate the contract.

Certain other risks – such as unexploded munitions, asbestos and archeological remains – are typically borne by employers.

3.7 Which party usually bears the risk of a change in law affecting the completion of the works under construction contracts in your jurisdiction?

The allocation of risk for a change in law affecting the project largely depends on the contract itself, as this matter is not regulated by mandatory rules and may be agreed between the parties.

Public law contracts generally provide for protection against changes in law that would specifically affect the project. Absent specific provision in the contract, protection may be offered under the case law theories of *imprévision* or *fait du prince*. Under the former and provided its conditions are met, the contracting authority provides financial compensation to the contractor where the economic balance of the contract has been disrupted by an unforeseeable event beyond the parties' control. Such unforeseeable events include measures adopted by public authorities in general. The theory of *fait du prince* entitles the contractor to full compensation if the contracting authority adopts a measure (e.g., tax or social policy) which was unforeseeable and produces an adverse impact specifically on the contractor or one of the essential elements of the contract. However, it is rarely used today.

In the private sector, and in the absence of any contractual clause dealing with the allocation of risk in the case of unforeseen circumstances, contractors may possibly invoke the principle of *imprévision* introduced by the new Article 1195 of the Civil Code (see question 3.6).

3.8 Which party usually owns the intellectual property in relation to the design and operation of the property?

The designer (usually the architect) is the owner of the intellectual property rights in the design. These rights form part of the designer's intangible property in its *oeuvre de l'esprit* (creation) under the Intellectual Property Code (Articles L111-1, L112-2). This right is independent from the employer's property right over the work, which does not automatically confer a right to the design. For this reason, design contracts usually grant the employer a licence or assign reproduction and representation rights.

One aspect of the designer's intangible property is the *droit moral*. Provided it is an original design, the *droit moral* entitles the designer to oppose any modification to the design during construction and after completion. The *droit moral* is perpetual, inalienable and imprescriptible. In practice, however, it is subject to limitations, such as when public interest demands modifications (including demolition).

3.9 Is the contractor ever entitled to suspend works?

In the private sector, the contractor may suspend works in certain circumstances. This includes, for example, when the other party is in default, provided the failure to perform is sufficiently serious (*l'exception d'inexécution*). A right to suspend may also arise when the employer has not paid the contractor and not provided a payment guarantee. This rule is mandatory and cannot be excluded by agreement. The right to suspend is also recognised, subject to specific requirements, in the Housing and Construction Code (Article L111-3-1).

In the public sector, the contractor's right to suspend works is generally more limited, reflecting the need to ensure the continuity of public services.

3.10 Are there any grounds which automatically or usually entitle a party to terminate the contract? Are there any legal requirements as to how the terminating party's grounds for termination must be set out (e.g. in a termination notice)?

In the public sector, a construction contract terminates automatically in case of *force majeure* or if the contractor ceases to exist (e.g., because of death, bankruptcy or civil incapacity). The employer also has the right to terminate the contract unilaterally when public interest considerations require it or the contractor commits a sufficiently serious breach. The contractor, on the other hand, may not terminate the contract unilaterally absent an express contractual right (save for *force majeure*).

In the private sector, a contract can be terminated by one party unilaterally or through court proceedings in the event of a sufficiently serious breach by the other party (e.g., abandonment of the construction site, significant delay, serious non-compliance with contractual specifications, or the employer's failure to pay, etc.). For lump-sum contracts, there is a statutory default regime allowing the employer to unilaterally terminate the contract at will. Otherwise, termination may occur by operation of a *clause résolutoire* (express termination clause), which must be invoked in good faith. The clause must specify the obligations the non-performance of which will give rise to the right to terminate.

Termination is generally subject to a requirement that prior notice is given that affords the other party a reasonable time to cure the breach.

3.11 Do construction contracts in your jurisdiction commonly provide that the employer can terminate at any time and for any reason? If so, would an employer exercising that right need to pay the contractor's profit on the part of the works that remains unperformed as at termination?

Construction contracts with public authorities commonly provide that the employer may terminate at any time for public interest reasons. This right exists notwithstanding any provision to the contrary. Subject to any contrary contractual provisions, the contractor is entitled to full compensation, including its *perte subie* (direct losses) and *manque à gagner* (lost profits).

In the private sector, there is a statutory regime that allows the employer to terminate lump-sum contracts at will, in which case the contractor is entitled to be fully compensated (i.e., for costs incurred, works already performed and profits lost). Otherwise, the employer is generally only entitled to terminate for cause (as to which, see Article 22 of the AFNOR NF P 03-001 form for an example of the causes for which the employer may terminate).

3.12 Is the concept of *force majeure* or frustration known in your jurisdiction? What remedy does this give the affected party? Is it usual/possible to argue successfully that a contract which has become uneconomic is grounds for a claim for *force majeure*?

The principle of *force majeure* is codified in French law. The statutory regime defines a *force majeure* event as an event outside of the parties' control, that could not have been reasonably foreseen at the time the contract was made and the effects of which cannot be prevented through appropriate measures. For *force majeure* to apply, the event must render the performance of the contract impossible, and not simply uneconomic.

If the impossibility of performance is permanent, the contract can be automatically terminated. If it is temporary, the parties' obligations are suspended until the event ceases to exist, unless the delay caused by the event is such that termination is justified.

The parties may agree to vary the statutory regime by contract.

Where an event has rendered performance of the contract uneconomic, in both the private and public sectors, a party may seek to invoke the principle of hardship (*imprévision*) (see questions 3.6 and 3.7).

3.13 Are parties, who are not parties to the contract, entitled to claim the benefit of any contractual right which is made for their benefit? E.g. is the second or subsequent owner of a building able to claim against the contractor pursuant to the original construction contracts in relation to defects in the building?

The *effet relatif des contrats* (principle of privity of contracts) applies but may be subject to certain exceptions. Parties may agree to confer rights on third parties by way of a *stipulation pour autrui* (for example, to a lender financing the project when no direct agreement exists).

Additionally, certain exceptions to the privity of contracts are provided by law (e.g., Civil Code, Article 1341-3). In certain circumstances, sub-contractors may claim payment directly against the employer (*paiement direct* when the employer is a public authority and *action directe* when the employer is a private person).

The principle of *l'accessoire suit le principal* may entitle subsequent owners to pursue the contractor under the initial contract. Subsequent owners are also entitled to claim against the contractor under the biennial and decennial guaranties.

3.14 On construction and engineering projects in your jurisdiction, how common is the use of direct agreements or collateral warranties (i.e. agreements between the contractor and parties other than the employer with an interest in the project, e.g. funders, other stakeholders, and forward purchasers)?

Direct agreements are commonly used in project finance to protect the lenders' interests by conferring specific rights, such as step-in rights in the event of default. In the public sector, the consent of the relevant authority is required before the contractor may be replaced. Lenders are often granted a security – known as a *Daily* assignment – by which the core receivables of the project may be assigned to them.

Collateral warranties are also used, the most frequent being the parent company guarantee, which are generally required in the form of a *cautionnement* or *garantie autonome* (see question 1.9).

3.15 Can one party (P1) to a construction contract, who owes money to the other (P2), set off against the sums due to P2 the sums P2 owes to P1? Are there any limits on the rights of set-off?

In France, set-off may operate by law (*compensation légale*) or contract (*compensation conventionnelle*).

Legal set-off is subject to certain conditions. The debts must be: interrelated; fungible; certain; immediately due; and payable. For example, an employer may set-off delay liquidated damages against the sums it owes to the contractor if the liquidated damages are not contested.

The parties may limit or expand their set-off rights by contract.

3.16 Do parties to construction contracts owe a duty of care to each other either in contract or under any other legal doctrine? If the duty of care is extra-contractual, can such duty exist concurrently with any contractual obligations and liabilities?

French law does not recognise a contractual or tortious duty of care, as that duty is understood in common law countries. Analogous obligations do, however, apply (e.g., the obligation of good faith, the pre-contractual obligation to inform, the contractor's duty to advise, the employer's duty of cooperation, etc.).

A *devoir de vigilance* (corporate duty of vigilance) has recently been created. This duty, which applies to large companies in France, requires a party to, *inter alia*, identify and mitigate social, environmental and governance risks related to their activities, but also those of their suppliers or subcontractors, or companies they control.

3.17 Where the terms of a construction contract are ambiguous, are there rules which will settle how that ambiguity is interpreted?

In general terms, in the event of ambiguity, a French court will interpret the contract by seeking the common intention of the parties (*commune intention*). If the parties' actual common intention cannot be determined, the contract is interpreted according to the meaning that a reasonable person would have given to it in the same situation.

The objective is to discover the parties' *volonté réelle* (real common intention), which prevails over the literal meaning of the terms. To do so, the judge may rely on the parties' behaviour before and after the conclusion of the contract. However, clear and unambiguous terms are, in principle, not open to revision by way of interpretation.

3.18 Are there any terms which, if included in a construction contract, would be unenforceable?

Any term that purports to exclude or modify the *lois de police* or *règles d'ordre public*, which are mandatory rules, will be unenforceable (*réputée non écrite* or *nulle*) (see question 3.3). The obligation to negotiate, conclude and perform a contract in good faith is an example of such a rule. Moreover, an obligation subject to a condition, the fulfilment of which depends solely on the will of the debtor (i.e., a *clause potestative*), may be unenforceable.

3.19 Where the construction contract involves an element of design and/or the contract is one for design only, are the designer's obligations absolute or are there limits on the extent of his liability? In particular, does the designer have to give an absolute guarantee in respect of his work?

Liability for design works is subject to the same rules as for construction works. The design must comply with the contractually agreed requirements. This obligation is one of result (*obligation de résultat*) and is thus absolute. The designer's work is also subject to mandatory warranties (see questions 3.5 and 3.20), and the designer may be jointly and severally liable with the construction contractor.

3.20 Does the concept of decennial liability apply in your jurisdiction? If so, what is the nature of such liability and what is the scope of its application?

Decennial liability does apply in France. The *garantie décennale* is a 10-year statutory warranty that cannot be limited and applies notwithstanding any contractual provision to the contrary. It applies to *constructeurs d'un ouvrage* (construction contractors), widely defined (e.g., architects, contractors, persons who sell, after completion, a work that he built or had built, etc.). Such contractors are strictly liable to owners and purchasers, for a period of 10 years after handover, for defects (including ground defects – *vices du sol*) which impair the solidity of the work or its inseparable equipment, or render it unfit for its purpose. The contractors can only escape liability by proving that the damage was caused by an external cause (e.g., *force majeure*, employer's fault, act of a third party). Decennial liability is subject to abundant case law which continues to define and expand its limits.

4 Dispute Resolution

4.1 How are construction disputes generally resolved?

In the private sector, parties tend to choose to resolve their domestic construction disputes in civil courts, even for major projects. There is, however, increasing recourse to mediation or fast-track arbitration proceedings.

The majority of disputes under public construction contracts are settled by way of a preliminary amicable settlement phase, which allows the parties to refer their dispute to a special committee – *Comité Consultatif de Règlement Amiable des litiges* (CCRA) – which issues a non-binding decision. Rates of settlement by well-organised CCRA's are high. Otherwise, disputes are commonly referred to administrative courts for final resolution.

4.2 Do you have adjudication processes in your jurisdiction (whether statutory or otherwise) or any other forms of interim dispute resolution (e.g. a dispute review board)? If so, please describe the general procedures.

There are no statutory adjudication processes in France, but the dispute review boards are becoming more popular in the private sector. For example, dispute review boards have been provided for in some of the contracts relating to the Grand Paris Project, which is currently the largest infrastructure project in Europe (with 200km of new metro lines and 68 stations, for a cost in excess of €32.5 billion).

4.3 Do the construction contracts in your jurisdiction commonly have arbitration clauses? If so, please explain how, in general terms, arbitration works in your jurisdiction.

In public contracts, arbitration clauses are rare. Save in certain, limited circumstances, arbitration is not available to French public entities. Where the dispute is international, public entities may not rely on domestic law restrictions and are bound by arbitration agreements they enter into.

In the private sector, arbitration is more common, but civil litigation still prevails. Where parties do agree to arbitration, they most frequently choose arbitration under the ICC rules or the rules of the French arbitration association (AFA).

4.4 Where the contract provides for international arbitration, do your jurisdiction's courts recognise and enforce international arbitration awards? Please advise of any obstacles (legal or practical) to enforcement.

France is viewed as an “arbitration-friendly” jurisdiction and enforcement may only be refused in certain limited circumstances, which are set out in Article 1520 of the Civil Procedure Code. In certain respects, French law on the enforceability of arbitral awards is more favourable than that provided in the New York Convention of 1958 (e.g., French courts may recognise and enforce awards that have been set aside at the seat). Awards may only be set aside in limited circumstances. To be enforceable in France, the award must receive an exequatur, a seal affixed on the original and/or the copy of the award on a without-notice basis.

4.5 Where a contract provides for court proceedings in your jurisdiction, please outline the process adopted, any rights of appeal and a general assessment of how long proceedings are likely to take to reduce: (a) a decision by the court of first jurisdiction; and (b) a decision by the final court of appeal.

Where a contract provides for court proceedings, administrative courts will have jurisdiction over disputes arising out of contracts with public entities; and civil courts over disputes arising out of contracts involving private parties. Most civil courts have a section dedicated to construction matters. Courts of both the administrative and judicial orders have wide powers to order interim measures, including *référé-provision*, which allows a court to order payment of an amount where the existence of the obligation

to pay cannot be reasonably contested. All decisions can be appealed before a competent court of appeal (*Cour d'appel* or *Cour administrative d'appel*). Final review on points of law, not fact, is available before the competent superior court (*Cour de cassation* or *Conseil d'Etat*).

The length of proceedings depends on the competent jurisdiction and complexity of the dispute. On average, administrative courts are likely to render a first instance decision in less than a year, and civil courts in more than a year. However, this average tends to double if recourse is made to a judicial expert, who are often appointed in construction disputes in France. The time required to obtain a decision on appeal is usually at least 13 months.

4.6 Where the contract provides for court proceedings in a foreign country, will the judgment of that foreign court be upheld and enforced in your jurisdiction? If the answer depends on the foreign country in question, are there any foreign countries in respect of which enforcement is more straightforward (whether as a result of international treaties or otherwise)?

The judgments of courts of EU Member States enjoy automatic recognition in France, but a *titre exécutoire européen* (European enforcement order) or a declaration of enforceability is generally required to enforce a judgment.

Foreign judgments are otherwise enforceable in France subject to receiving an exequatur, which is granted, absent a specific international agreement, under three cumulative conditions: the foreign court had jurisdiction; there was no fraud; and the judgment is compatible with French international public policy.



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Germany

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1 Making Construction Projects

1.1 What are the standard types of construction contract in your jurisdiction? Do you have: (i) any contracts which place both design and construction obligations upon contractors; (ii) any forms of design-only contract; and/or (iii) any arrangement known as management contracting, with one main managing contractor and with the construction work done by a series of package contractors? (*NB* For ease of reference throughout the chapter, we refer to “construction contracts” as an abbreviation for construction and engineering contracts.)

Construction services in Germany are usually awarded in the form of individual works contracts or, in the case of larger construction projects, to a general contractor (“GU contract”). In addition, to avoid overlapping warranties, some contracts for services from a single trade are also awarded to a partial general contractor (the so-called “package GU contract”). In principle, the owner must make the necessary design available to the contractor. Often only a part of the design services (the execution design) is provided by the contractor, while the so-called approval design remains the responsibility of the owner or his architects.

German law essentially distinguishes between unit price and lump-sum contracts. In the case of lump-sum contracts, there is a further distinction between detailed lump-sum contracts and simple or complex global lump-sum contracts.

In the case of a unit price (remeasurement) contract, the owner bears the mass and quantity risk, i.e. the services are invoiced according to the quantities and masses incurred and determined by a measurement (see § 2 para. 2 of the German Construction Contract Procedures – “VOB/B”). In the case of a detailed lump-sum contract, this risk is transferred to the contractor and cannot, therefore, demand additional remuneration due to deviations in quantity and/or mass. Additional costs resulting from modified and/or additional services (see § 2 para. 7 No. 2 VOB/B) remain unaffected. In the case of simple and complex global lump-sum contracts, the contractor must take on even more risk, namely with regard to the sufficiency of the design. In contrast to the detailed lump-sum contract (with detailed specifications), the global lump-sum contract describes the performance owed more functionally. Of course, a combination of the different types of contract is also possible and common practice.

1.2 How prevalent is collaborative contracting (e.g. alliance contracting and partnering) in your jurisdiction? To the extent applicable, what forms of collaborative contracts are commonly used?

Since the mid-1990s, partnering models have successfully established themselves in local construction markets, especially in the USA and Great Britain. In Germany, the emergence of partnering models only occurred at the end of the 20th century, partly as a result of the construction boom following reunification. Beginning in 2002, major German construction conglomerates developed project-related business models for the German construction market based on the partnering philosophy. In recent years, partnering models have become increasingly present in the German construction industry, especially with regard to large-scale construction projects. Small and medium-sized construction projects are still carried out in accordance with the types of contract described under question 1.1.

A wide variety of partnering models are commonly used. Project management is based on partnership models, which include: long-term and project partnering; one- and two-stage partnering, guaranteed maximum price (“GMP”); construction management at agency/at risk; and alliance contracting. Combinations are also possible, including those in conjunction with other management approaches. Most recently, several integrated project delivery (“IPD”)-based pilot projects have been introduced, and in March 2020, the official German adaptation of the FAC-1 framework alliance contract was released for use in the German market (available at <https://shop.reguvis.de/bau-und-architektenrecht-hoai/fac-1-e-book/>).

1.3 What industry standard forms of construction contract are most commonly used in your jurisdiction?

In Germany, construction contracts are concluded almost exclusively on the basis of the “contract for works” provisions of the German Civil Code (“BGB”) (§§ 631 *et seq.* BGB), including those of the Construction Contract Law (§§ 650a *et seq.* BGB), and/or the contractual conditions of the VOB/B. The latter must be agreed separately. Contracts for architectural and engineering services are subject not only to the provisions of the law on contracts for works (§§ 631 *et seq.* BGB in conjunction with §§ 650p *et seq.* BGB), but also to the price specifications of the Fee Regulations for Architects and Engineers (“HOAI”). Other standard forms of contract, such as those published by the International Federation of Consulting Engineers (“FIDIC”), are virtually never used in purely domestic German construction projects.

1.4 What (if any) legal requirements are there to create a legally binding contract (e.g. in common law jurisdictions, offer, acceptance, consideration and intention to create legal relations are usually required)? Are there any mandatory law requirements which need to be reflected in a construction contract (e.g. provision for adjudication or any need for the contract to be evidenced in writing)?

Under German law, a contract is generally concluded when two identical declarations of intent are made; namely, offer and acceptance. Furthermore, depending on the type of contract, there may be additional minimum requirements. As a rule, these include the contracting parties, performance and counter-performance. A special feature of a works contract is that a specific counter-performance must be expressly agreed. According to § 632 para. 1 BGB, remuneration is deemed to be tacitly agreed if, under the circumstances, the contractor's performance can only be expected in return for compensation. If the amount of the remuneration is not expressly agreed, the usual remuneration for the work performed in the locality is to be regarded as agreed (*cf.* § 632 para. 2 BGB). From a formal point of view, a contract for works can generally be concluded in writing, orally or by implication. The same applies to variations or even to the architect's contract. For a few types of contract, the law on works contracts prescribes a certain form, such as the consumer building contract (where there is a writing requirement, *cf.* § 650i BGB in conjunction with § 126b BGB) or the developer contract (here a notarial contract is required due to the transfer of ownership of land or residential/partial ownership; *cf.* § 650u BGB in conjunction with § 126b and § 311b BGB).

1.5 In your jurisdiction please identify whether there is a concept of what is known as a "letter of intent", in which an employer can give either a legally binding or non-legally binding indication of willingness either to enter into a contract later or to commit itself to meet certain costs to be incurred by the contractor whether or not a full contract is ever concluded.

Rights and obligations can arise for both contracting parties as early as the pre-contract phase through the commencement of contractual negotiations, the initiation of a contract, as well as through similar business contacts and the conduct of the parties (see § 311 (2) BGB). Typical ("agreed upon") pre-contractual obligations in Germany are the so-called Letter of Intent ("LOI") and the pre-contractual agreement.

The LOI is not regulated by law in Germany, but has been adopted from common law practice in Anglo-Saxon legal systems. In the event of large-scale, complex contracts, its purpose is usually to structure contractual negotiations, as well as to determine the status of such negotiations and the (partial) results achieved. If desired, certain duties may be stipulated; in particular, exclusivity, confidentiality and, if appropriate, reimbursement of costs in the event the contract is not concluded. Depending on its content, the LOI may take the form of a mere protocol of negotiations, a declaration of intent to conclude a contract, a pre-contract or even a binding contract, the terms of which may have to be determined by interpreting the content of the letter.

In contrast, a pre-contractual agreement is a contract under the law of obligations with a primary obligation to subsequently conclude the main contract. As a rule, the main contract must be concluded in accordance with the terms of the pre-contractual agreement. A secondary obligation on the parties is to refrain from performing any act that could negatively affect the conclusion of the main contract.

1.6 Are there any statutory or standard types of insurance which it would be commonplace or compulsory to have in place when carrying out construction work? For example, is there employer's liability insurance for contractors in respect of death and personal injury, or is there a requirement for the contractor to have contractors' all-risk insurance?

Although there is no compulsory third-party liability insurance in Germany, it is nevertheless customary in the industry, and the vast majority of building contractors and architectural firms take out such insurance in order to protect themselves against third-party claims. However, there is a legal obligation for all freelance architects and engineers to be adequately insured against such third-party claims.

For complex construction projects with correspondingly complex project structures and high risks, tailor-made project insurance policies are generally taken out in Germany to cover such complex risk profiles. Which individual insurance coverages are bundled together in the respective project policy depends on the individual risks of the project.

1.7 Are there any statutory requirements in relation to construction contracts in terms of: (a) labour (i.e. the legal status of those working on site as employees or as self-employed sub-contractors); (b) tax (payment of income tax of employees); and/or (c) health and safety?

It is important for the owner to obtain confirmation from the contractor that all legal, contractual and wage regulations governing the use of labour have been complied with, and to demand evidence demonstrating such compliance. Furthermore, it is recommended that security agreements (secured by bank guarantees) be put in place in the event that the owner is held liable for any amounts outstanding from the contractor. German law provides numerous legal regulations that impose a guarantor-like liability on the owner if the contractor does not meet his obligation to make the required employer payroll contributions for its employees (for social security contributions, see § 28e para. 3a of the Social Code ("SGB") IV; for accident insurance contributions, see § 150 III SGB VII). Furthermore, the owner is also liable if the contractor and/or its subcontractors fail to pay their employees the minimum wage prescribed by law or collective bargaining agreements (*cf.* § 14 of the Posted Workers Act – "AEntG").

An example of a special tax in the construction industry is the building deduction tax. This is a form of taxation designed to curb illegal employment in the construction industry. According to this law, commercial owners of construction services are obliged to withhold 15% of the invoice amount and pay it to the tax authority. If the contractor presents a so-called exemption certificate, this obligation falls away. The same applies if the *de minimis* limit of €15,000.00 per year is not exceeded. If the owner does not withhold the construction deduction tax, he may face a fine of up to €25,000.00 and, in particularly serious cases, even a prison sentence.

1.8 Is the employer legally permitted to retain part of the purchase price for the works as a retention to be released either in whole or in part when: (a) the works are substantially complete; and/or (b) any agreed defects liability period is complete?

The contract price is generally due and payable upon acceptance of the work (similar to substantial completion under common

law) (cf. § 641 para. 1 BGB). If the owner is entitled to the remedying of a defect, he can withhold a reasonable amount after the due date to secure this performance. A reasonable amount is usually double the cost of remedying the defect (see § 641 para. 3 BGB). Once the defect has been remedied by the contractor, he may demand payment of the withheld amount. Even in the case of payments on account, the owner may exercise his right to withhold payment if the invoiced services do not correspond with the actual progress on site. In addition, the parties may agree on security for an advance payment by the owner; for example, for ordering materials, or to ensure performance of the contract and any warranty period (see also question 1.9 below).

1.9 Is it permissible/common for there to be performance bonds (provided by banks and others) to guarantee the contractor's performance? Are there any restrictions on the nature of such bonds? Are there any grounds on which a call on such bonds may be restrained (e.g. by interim injunction); and, if so, how often is such relief generally granted in your jurisdiction? Would such bonds typically provide for payment on demand (without pre-condition) or only upon default of the contractor?

In the German construction industry, both performance and warranty bonds are very common. Under the German General Terms and Conditions Act ("GTCA"), the maximum permissible amount of a performance bond is 10% of the contract price; for a warranty bond, the maximum is 5% of the final invoice. Additionally, security can be provided through monies retained by the owner, of interim payments or of the final payment. The contractor generally has the right to have this retention money returned to him by providing another form of security, usually in the form of a bank guarantee. Bank guarantees in Germany are usually not issued on first (written) demand, as German courts have deemed such bonds to be impermissible under the GTCA. An exception exists for advance payment guarantees.

Conversely, the contractor may also have his claims on the building contract secured through a security mortgage on the building plot (see § 650e BGB) or through a so-called building craftsman's guarantee (see § 650f BGB). In the case of the latter, payment is only to be made if the owner acknowledges the contractor's claim for remuneration or has been ordered to pay such amounts in the form of an enforceable judgment.

1.10 Is it permissible/common for there to be company guarantees provided to guarantee the performance of subsidiary companies? Are there any restrictions on the nature of such guarantees?

Company guarantees are permissible and are also provided by some large construction groups, but are rather rare in the German construction industry as a whole. The same requirements apply to company guarantees as described in question 1.9 above. Otherwise, the parties may very rarely also agree on so-called letters of comfort ("*Patronatsklärungen*"), under which the parent company (the "Patron") guarantees the obligations of the subsidiary in the event of non-payment. These letters are not regulated by German law. In case of doubt, the obligation to pay under the contract must be determined by interpreting its terms (see Sections 133 and 157 BGB). In general, a distinction is made between soft letters of comfort (goodwill declarations) and hard letters of comfort (unrestricted indemnification of the obligated subsidiary in its internal and/or even external relationship with the creditor).

1.11 Is it possible and/or usual for contractors to have retention of title rights in relation to goods and supplies used in the works? Is it permissible for contractors to claim that, until they have been paid, they retain title and the right to remove goods and materials supplied from the site?

German law generally recognises retention of title rights (see § 449 BGB). However, the scope of their application is primarily limited to sales contracts and works contracts dealing with fungible goods, so that, as a rule, no claims based on a retention of title can be effectively substantiated in the case of a construction contract. The background is as follows: if a movable object becomes so connected to a property that it becomes an essential part of that property (a fixture), the ownership of the property also extends to the (once movable) object (§ 946 BGB). If objects are erected on a plot of land only for a temporary purpose, they are still considered movable and the enforcement of a claim of retention of title is still possible. It must be determined on a case-by-case basis whether such a fungible object retains its characteristic as such or is to be seen as a fixture.

2 Supervising Construction Contracts

2.1 Is it common for construction contracts to be supervised on behalf of the employer by a third party (e.g. an engineer)? Does any such third party have a duty to act impartially between the contractor and the employer? If so, what is the nature of such duty (e.g. is it absolute or qualified)? What (if any) recourse does a party to a construction contract have in the event that the third party breaches such duty?

The commissioning of construction/site supervision services is quite common in Germany, for which there are relevant requirements under German law. In general, a distinction is made between: (1) site supervision based on the service description of service phase 8 of HOAI (see question 1.3 above), which monitors the execution of the works in accordance with the building permit, the execution designs and the specifications, as well as with the generally accepted rules of technology and relevant regulations; (2) artistic site supervision, which monitors the implementation and conformity with the design; and (3) public-sector site management or specialist construction supervision, with corresponding obligations on the responsible authorities for the supervision of the public-law requirements in relation to a given construction project, which are defined in more detail, *inter alia*, in the 16 state building codes of the individual federal states in Germany. The construction supervisor, unlike a publicly appointed expert, primarily represents the interests of the party that commissioned it. Of course, it is bound by the law. From a technical point of view, the specifications of the recognised rules of technology must be observed unless otherwise agreed. If the construction supervisor culpably violates any contractual obligations – in particular, if defects in the work, which should have been detected, are not detected – then claims for damages against the construction supervisor may, of course, arise. This is by no means an exception; rather, it is the subject of many court decisions and proceedings in Germany.

2.2 Are employers free to provide in the contract that they will pay the contractor when they, the employer, have themselves been paid; i.e. can the employer include in the contract what is known as a “pay when paid” clause?

German law recognises a kind of “pay when paid” rule in § 641 (2) BGB, but this is primarily intended to protect the contractor and not the owner. According to § 641 para. 2 BGB, the remuneration of a sub-contractor becomes due once the contractor has received his remuneration from a third party (the owner) or if the work has been accepted by the third party. The contractor cannot then object that the work of the sub-contractor is not ready for acceptance.

Irrespective of the above, payment for services is typically only based on the respective contractual relationships between the owner and the contractor (or between the contractor and its sub-contractors). In the case of a contract for works, the payment is due when acceptance has been declared by the owner and the final invoice has been issued by the contractor. The question of whether performance is ready for acceptance is generally assessed purely within the respective contractual relationship and is not dependent on any contractual relationships with third parties. Therefore, an agreement is not permitted under the GTCA, where payment to the sub-contractor is dependent on the receipt by the contractor of the owner’s payment, if and to the extent that the sub-contractor’s work is ready for acceptance.

2.3 Are the parties free to agree in advance a fixed sum (known as liquidated damages) which will be paid by the contractor to the employer in the event of particular breaches, e.g. liquidated damages for late completion? If such arrangements are permitted, are there any restrictions on what can be agreed? E.g. does the sum to be paid have to be a genuine pre-estimate of loss, or can the contractor be bound to pay a sum which is wholly unrelated to the amount of financial loss likely to be suffered by the employer? Will the courts in your jurisdiction ever look to revise an agreed rate of liquidated damages; and, if so, in what circumstances?

In Germany, there are two means of ensuring that the contractual deadlines are kept; namely, contractual penalties and liquidated damages clauses. Contractual penalties (“*Vertragsstrafen*”) are regulated in §§ 339 to 345 BGB. The ability to claim contractual penalties is independent of whether actual damages have been incurred, and generally serves two purposes. On the one hand, it is intended to exert pressure on the contractor to fulfil his main obligation (a leverage function). On the other hand, it is intended to cover any damages which may have been incurred as a result of the delay (a compensatory function). Since it does not presuppose any damage, it is particularly suitable for cases where it is difficult or impossible to determine the amount of damage.

Liquidated damages clauses (“*Pauschalierter Schadensersatz*”) are seen as a pre-estimate of damage likely to be incurred upon the occurrence of the event anticipated in the contract. Since it is based on an existing claim for compensation, it merely reverses the burden of proof with regard to its amount. If the breaching party believes that the actual damages incurred constitute less damage than those recovered under the liquidated damages clause, he must prove this. For both contractual penalties and lump-sum damages, the law and case law impose a large number of requirements for the clause to be effective, which require an in-depth analysis on a case-by-case basis. In general, however, neither may be unreasonably high. Particularly with regard to delay damages, if the amount of the claim is determined by

days of delay, it must be stated as a fixed amount per day, with a maximum amount (i.e. 0.1% of the contract price per day up to a maximum of 5% of the contract price).

3 Common Issues on Construction Contracts

3.1 Is the employer entitled to vary the works to be performed under the contract? Is there any limit on that right?

In the case of construction contracts based on the statutory provisions governing works contracts of the BGB, as well as on the VOB/B, the owner is permitted to instruct the contractor to make changes to the agreed scope of work and/or to make changes that are necessary to achieve the agreed scope of work (additionally required services) (see § 650b BGB or §§ 1 paras 3 and 4 VOB/B). Both BGB and VOB/B contracts differ fundamentally with respect to the particulars concerning the agreement or instruction of variations and establishing the price for such changes.

The right to instruct changes is limited to the reasonableness of the change or variation to the contractor; in particular, whether the contractor is technically and/or operationally equipped to carry out the changed service.

3.2 Can work be omitted from the contract? If it is omitted, can the employer carry out the omitted work himself or procure a third party to perform it?

In general, only the owner has the right to omit services from the agreed scope of the contract. From a legal point of view, this represents a partial termination of the contract (see § 648 BGB or § 8 para. 1 VOB/B). If the owner makes such an omission, the contractor is entitled to demand the agreed remuneration, less any savings as a result of the omission or such savings as would have been realised but for his wilful refusal to repurpose his labour elsewhere.

The contractor, on the other hand, has no right of his own to reduce the scope of his performance under the contract. If the contractor fails to perform services owed under the contract, this will lead to a defect in the work, or will constitute a breach of contract. If the conditions of the VOB/B have been agreed, the owner may terminate the contract prior to acceptance if the contractor does not remedy the defect (i.e. perform) within a reasonable period of time. The owner may then remedy the defect himself or have it remedied by a third party and claim any additional costs/damages from the contractor for breach of contract. In the case of a BGB construction contract, the rights in respect of defects shall, in principle, only exist after acceptance of the services. Otherwise, the owner may seek substitute performance or demand payment for the removal of the defect in advance.

3.3 Are there terms which will/can be implied into a construction contract (e.g. a fitness for purpose obligation, or duty to act in good faith)?

In Germany, the principles of freedom of contract and private autonomy apply. The parties are free to determine the terms of their contracts and to deviate from the law, as long as all mandatory provisions are adhered to. Further limits to these principles are the prohibitions of immorality and usury, and the general principle of “good faith”. If contracts or contractual provisions are drafted to be used on more than one occasion (this

will be presumed in the case of two identical contracts/contractual provisions), the special protective provisions of the GTCA (see §§ 305 *et seq.* BGB) apply, not only to business-to-consumer (“B2C”) but also, with some limitations (see §§ 308 and 309 BGB), to business-to-business (“B2B”) transactions.

Regarding the “fitness for purpose” obligation, this is a question of the work being free of material defects and is regulated by law. According to § 633 para. 2 BGB, the work is free of material defects if it has the agreed quality. If the quality has not been agreed, the work is free of material defects if: (1) it is suitable for its intended use under the contract; otherwise (2) it must be suitable for ordinary use and have a quality which is customary for works of the same kind and which the owner can expect according to the nature of the work.

The duty to act in “good faith” is enshrined in § 242 BGB (“*Treue und Glauben*”). This duty arises in the German construction context in particular through the “duty to cooperate”. Since construction requires a long and trustworthy partnership between the parties, they should, if possible, strive for amicable solutions and not rely on (alleged) legal/contractual remedies; in particular, the refusal of performance or payment.

3.4 If the contractor is delayed by two concurrent events, one the fault of the contractor and one the fault or risk of his employer, is the contractor entitled to: (a) an extension of time; and/or (b) the costs arising from that concurrent delay?

Whether a contractor may be entitled to an extension of time and/or additional costs due to concurrent employer and contractor delays and/or disruptions requires a case-by-case assessment and can therefore only be answered in very general terms. In the case of the BGB and VOB/B contracts, the contractor is entitled to an extension of time in the event of a delay caused by an event within the owner’s responsibility. In the case of concurrent delays or disruptions running parallel to each other, the contractor is generally only entitled to an extension of time; in such a case, however, he can only claim damages for the period of time during which the disruption was caused by or within the responsibility the owner and the contractor himself was capable of performing.

3.5 Is there a time limit beyond which the parties to a construction contract may no longer bring claims against each other? How long is that period and when does time start to run?

The statutory limitations period under German law for contractual claims is three years from the end of the year in which the right to claim arose and the injured party knew, or should have known, of that right. For example, a contractor’s claim for remuneration shall become statute-barred three years from the end of the year of acceptance and issuance of the final invoice.

Furthermore, the owner can assert claims for defects up to five years after acceptance in the case of a BGB building and architect contract, and up to four years after acceptance in the case of a VOB/B contract. Longer or shorter periods are permissible by agreement, whereby the GTCA prescribes limits. In determining whether an agreed modification of the limitations period is effective, case law focuses on whether there is a reasonable factual basis for the change. For example, an extension of warranty claims to 10 years due to leaks in parts of buildings caused by pressurised water (“*weiße Wanne*”) has been recognised.

3.6 Which party usually bears the risk of unforeseen ground conditions under construction contracts in your jurisdiction?

Unforeseeable ground conditions generally fall within the owner’s sphere of responsibility. However, through individually negotiated agreements with the contractor (not in general terms and conditions), it is possible to transfer these risks to the contractor. The burden of proof that an individually negotiated agreement exists lies with the party who seeks to rely on it; in this case, the owner.

3.7 Which party usually bears the risk of a change in law affecting the completion of the works under construction contracts in your jurisdiction?

The party who bears the risk of a change in law is always determined on case-by-case basis; for example, the contractor generally bears the risk of changes in the law because, under German law, he owes the owner a work that is fit for purpose. If, due to a change in the law, the performance must be executed differently than originally planned, the contractor may have a claim against the owner for additional remuneration due to the changed execution of the works. In this case, the owner would bear the risk in relation to the additional costs. It is also permissible to address the risk of changes in law contractually.

3.8 Which party usually owns the intellectual property in relation to the design and operation of the property?

The author is the person who is individually responsible for the creation of a work. In construction projects, this is usually the architect. The copyright created by the author through his/her creation is an absolute right which cannot be transferred (*cf.* Section 29 (1) of the Copyright Law – “*UrhG*”). However, it is possible to transfer rights of use to third parties through various contractual arrangements (e.g. as an exclusive or limited right, unlimited or time-limited right, etc.) in relation to the work. For a copyright to come into existence at all, the work must contain a minimum level of creative effort and personal character. This is usually the case with architectural designs of an exceptional nature, but not necessarily for buildings which are more functional in nature.

3.9 Is the contractor ever entitled to suspend works?

Both BGB and VOB/B construction contracts stipulate a large number of instances in which the contractor may permissibly suspend his performance. German law generally differentiates between temporary and permanent suspension of services. A temporary (permissible) suspension of performance occurs when the contractor is hindered in the execution of his performance for reasons attributable to the owner (see § 6 VOB/B); for example, where the owner fails to provide the contractor with the necessary design for the execution of the works. The same applies in the case of *force majeure* or other unavoidable circumstances. The contractor may also be entitled to suspend performance in the event of non-payment by the owner. However, the contractor is generally obliged to undertake all reasonable measures to continue performance despite the hindrance (e.g. by changing the construction process).

A permanent suspension of performance is deemed to be permissible if the performance of the services becomes legally or factually impossible (*cf.* § 275 BGB), e.g. if a building permit is irrevocably denied. In this case the contractor will be “released” from his contractual obligations. For suspension of performance by the contractor to be permissible, it is always a prerequisite that the circumstances giving rise to the suspension are not attributable to him or to risks which are to be borne by him.

3.10 Are there any grounds which automatically or usually entitle a party to terminate the contract? Are there any legal requirements as to how the terminating party’s grounds for termination must be set out (e.g. in a termination notice)?

Under the BGB law on construction contracts, both parties have the right to extraordinary termination for good cause (see § 648a BGB). In addition, the owner is entitled to ordinary (free) termination of the construction contract (*cf.* § 648 BGB, Nos 3.2 and 3.11). Furthermore, § 643 BGB provides for termination by the contractor in the event of failure to cooperate by the owner. If the VOB/B has been agreed, the parties are entitled to further/modified reasons for termination in §§ 8 and 9 (e.g. in the event of insolvency). The party seeking to terminate the contract bears the burden of proof that the conditions for termination have been met (e.g. prior warning, if necessary). In the case of termination, especially for good cause, the reasons for termination should be stated in detail. It is not recommended to “put off” providing the grounds for termination, even though this may be permissible in individual cases. Under the VOB/B, notices of termination must be made in writing (*cf.* Sections 8 and 9 VOB/B); otherwise, although not required, it is recommended for the purposes of proof.

3.11 Do construction contracts in your jurisdiction commonly provide that the employer can terminate at any time and for any reason? If so, would an employer exercising that right need to pay the contractor’s profit on the part of the works that remains unperformed as at termination?

According to § 648 BGB, the owner may terminate the contract at any time and for any reason, or for no reason, until the works have been completed. If the owner terminates the contract, the contractor is entitled to demand the agreed remuneration, less any savings as a result of the termination or such savings as would have been realised but for his wilful refusal to repurpose his labour elsewhere. It is generally presumed that the contractor is then entitled to 5% of the agreed remuneration for the part of the work not yet performed. The latter presumption is rebuttable, so that a greater claim for remuneration may also be justified.

3.12 Is the concept of *force majeure* or frustration known in your jurisdiction? What remedy does this give the affected party? Is it usual/possible to argue successfully that a contract which has become uneconomic is grounds for a claim for *force majeure*?

VOB/B contracts address *force majeure* specifically in § 6; in BGB construction contracts, it is regulated through the doctrine of impossibility in § 275. In general, performance is excused for the duration of the disruption caused by the *force majeure* event. The contractor may further be entitled to an extension of time. The extension of time is calculated according to the duration of the hindrance plus an allowance for resuming work and, if

applicable, taking into account having to resume performance during a less favourable time of year. As a rule, the contractor is not entitled to additional costs or compensation for damages, since *force majeure* does not fall within the owner’s sphere of risk.

A contract becoming uneconomical does not constitute *force majeure* under German law. For this purpose, German law provides for the doctrine of frustration of purpose (*cf.* § 313 BGB). If the circumstances which formed the basis of the contract changed so significantly after the conclusion of the contract that the parties would not have concluded the contract or would have concluded it under different terms had they foreseen this change in circumstances, an adjustment or rescission of the contract can be demanded. Proving frustration is a high bar, and the party seeking to invoke frustration must show that performance of the contract in its current form is patently unreasonable.

3.13 Are parties, who are not parties to the contract, entitled to claim the benefit of any contractual right which is made for their benefit? E.g. is the second or subsequent owner of a building able to claim against the contractor pursuant to the original construction contracts in relation to defects in the building?

Rights and obligations arising from a contract generally only exist between the respective contracting parties. Third parties may only assert rights and/or incur obligations arising from a third-party contract if such a contract is agreed in their favour or if the respective claims arising from the contract have been assigned to third parties (insofar as there is no prohibition of assignment). The assignment of rights *vis-à-vis* the building contractor is common practice in the sale of real estate. It is also possible, unless contractually excluded, to re-assign these rights to additional third parties.

3.14 On construction and engineering projects in your jurisdiction, how common is the use of direct agreements or collateral warranties (i.e. agreements between the contractor and parties other than the employer with an interest in the project, e.g. funders, other stakeholders, and forward purchasers)?

Direct agreements or “collateral warranties” between the contractor and the above-mentioned third parties are rather unusual in Germany. In construction projects, the contractor is usually only in privity with the owner, his subcontractors and suppliers. The contractor’s bank is usually only involved as a guarantor for the provision of collateral guarantees for contract performance and liability for defects. Financing of the construction project is usually provided by the owner.

3.15 Can one party (P1) to a construction contract, who owes money to the other (P2), set off against the sums due to P2 the sums P2 owes to P1? Are there any limits on the rights of set-off?

A prerequisite for an effective set-off under German law is the existence of so-called set-off conditions. These exist where (1) the claims are reciprocal (the debtor of one claim must also be the creditor of the other claim), (2) the claims are similar (e.g. a monetary claim cannot be set off against a claim for the return of an object), (3) the principal claim is capable of being satisfied, and (4) the counterclaim is due. The set-off shall be made through a declaration of intent to set off. Set-offs are not permitted in a BGB construction contract (e.g. § 393 BGB). Set-offs can be excluded or limited by contract; however, under the GTCA, this

is only permissible to the extent that recognised or legally established claims are still allowed to be set off.

3.16 Do parties to construction contracts owe a duty of care to each other either in contract or under any other legal doctrine? If the duty of care is extra-contractual, can such duty exist concurrently with any contractual obligations and liabilities?

There are a number of duties and secondary obligations in German law with respect to construction contracts. In general, a duty is an action that cannot be enforced in its own right, but which is in one's own interest to be taken in order to avoid legal disadvantages or consequences. Secondary obligations include duties of care, custody, assistance or consideration (*cf.* § 241 (2) BGB), the violation of which may give rise to claims for damages in individual cases. Perhaps the most important obligation in this respect in German building law is the duty of cooperation under the building contract (see question 3.3 above), which is intended to achieve the amicable settlement of disputes and conflicts during construction.

3.17 Where the terms of a construction contract are ambiguous, are there rules which will settle how that ambiguity is interpreted?

Construction contracts usually contain provisions for dealing with contradictions or ambiguities with regard to the works to be performed (*cf.* § 1 para. 2 VOB/B) and, in the case of non-resolvable contradictions, the owner has the right to determine the performance at his own discretion (*cf.* § 315 BGB). In the absence of contractual provisions, courts will attempt to determine the intent of the parties by supplementary interpretation of the contract, whereby the construction contract is to be considered as a whole, including annexes and all other contractual elements. If the ambiguity or contradiction is still not resolved, the legal rules of interpretation are used. In the case of general terms and conditions, the doctrine of *contra proferentem* applies, where the ambiguity will be resolved against the party responsible for the ambiguity (usually the drafter).

3.18 Are there any terms which, if included in a construction contract, would be unenforceable?

All contractual provisions that violate mandatory law in Germany are invalid. In addition, contractual terms which do not relate to mandatory laws, but which interfere with and alter the core area of a statutory provision in such a way that they are incompatible with the intentions of the legislature, may also be held invalid. The key determining factors for the court's decision are: whether the contractual provision in question has been individually negotiated (in which case a more far-reaching deviation from the law is possible); whether such provisions are to be regarded as general terms and conditions; and, in the case of general terms and conditions, whether they were made in the context of a B2B or B2C transaction.

3.19 Where the construction contract involves an element of design and/or the contract is one for design only, are the designer's obligations absolute or are there limits on the extent of his liability? In particular, does the designer have to give an absolute guarantee in respect of his work?

Unless the parties have agreed otherwise, the architect is liable

in the same way as a building contractor according to the statutory provisions for works contracts; such liability is unlimited in scope and amount. A separate express warranty is therefore not required. However, it is not unusual for guarantees concerning a maximum construction cost, which may lead to additional liability of the architect in the event of (culpable) non-compliance, to be included in an architect's contract.

3.20 Does the concept of decennial liability apply in your jurisdiction? If so, what is the nature of such liability and what is the scope of its application?

"Decennial liability" does not exist in this form in German law. However, as explained in question 3.5 above, it is permissible by agreement to agree longer or shorter limitation periods for claims for defects. For example, the extension of the warranty claims of the owner to 10 years due to leakage of parts of the building due to pressurised water ("*weiße Wanne*") has been recognised by the courts.

4 Dispute Resolution

4.1 How are construction disputes generally resolved?

The vast majority of construction-related disputes in Germany, particularly those concerning payment for variations or the remedying of defects, are settled out of court by agreement of the parties. If such an agreement cannot be reached, the parties generally bring their dispute before ordinary courts.

Particularly with regard to disputes concerning defects, there is a special procedure for the inclusion of evidence presented by an independent judicial expert in Germany, the so-called independent evidence procedure ("*Selbständiges Beweisverfahren*"), which is often less complex and expensive for the claimant than a lawsuit. In most cases, the parties come to an agreement after the presentation of the independent expert's report, so this is an effective way of avoiding a long and expensive lawsuit. In the case of large construction projects, the parties tend to agree in the construction contract to have disputes settled by arbitration. The solicitation of an arbitrator's expert opinions, comparable to the above-mentioned independent evidence procedure, is also practised in Germany.

4.2 Do you have adjudication processes in your jurisdiction (whether statutory or otherwise) or any other forms of interim dispute resolution (e.g. a dispute review board)? If so, please describe the general procedures.

In Germany, it is permissible but not common for the parties to contractually agree to have their disputes heard by an adjudicator. Otherwise, preliminary injunctions can be sought before German courts. Particularly with regard to disputes concerning the owner's instructions and remuneration for variations in construction projects, German construction contract law provides for an easing of the burden of justifying the use of injunctive relief.

4.3 Do the construction contracts in your jurisdiction commonly have arbitration clauses? If so, please explain how, in general terms, arbitration works in your jurisdiction.

Arbitration agreements are primarily, and regularly, found in German construction contracts for major construction and infrastructure projects. In the case of small and medium-sized

construction projects, disputes are most often settled before the ordinary courts. The arbitration agreement generally takes the form of a contract between the parties. The arbitral award is usually legally binding on the parties and can be declared enforceable before state courts. The course of an arbitration proceeding is described in detail in the German Code of Civil Procedure (introduction, appointment of arbitrators, taking of evidence and oral proceedings, arbitral award, appeal against arbitral award, enforcement). The rules of arbitral institutions, such as the International Chamber of Commerce, sometimes provide for a slightly different procedure. In addition, the parties can, and often do, adapt the procedure to their own needs.

4.4 Where the contract provides for international arbitration, do your jurisdiction's courts recognise and enforce international arbitration awards? Please advise of any obstacles (legal or practical) to enforcement.

The formal requirements for cross-border arbitral proceedings are provided for in Germany. The legal basis and procedural rules for arbitration proceedings within the European Union are largely uniform. Pursuant to § 1060 German Code of Civil Procedure ("ZPO"), arbitral awards issued in Germany must be declared enforceable by a state court before any enforcement action can be taken against them. Foreign arbitral awards are recognised and enforceable under the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (§ 1061 ZPO).

4.5 Where a contract provides for court proceedings in your jurisdiction, please outline the process adopted, any rights of appeal and a general assessment of how long proceedings are likely to take to reduce: (a) a decision by the court of first jurisdiction; and (b) a decision by the final court of appeal.

In civil disputes where the amount in controversy exceeds €5,000, the regional court ("*Landgericht*") has original jurisdiction; where the amount in controversy is less than €5,000, original jurisdiction rests with the local courts ("*Amtsgericht*") (uncommon for construction projects). Appellate jurisdiction lies initially with the High Regional Court ("*Oberlandesgericht*"), whose decisions may be further appealed to the Federal Court of Justice ("*Bundesgerichtshof*").

Jurisdiction for administrative disputes, for example the issuance of permits, rests with the administrative courts ("*Verwaltungsgericht*") of the individual federal states. The appeals process is similar to that outlined above. Appeals are initially made to the High Administrative Court ("*Oberverwaltungsgericht*"), whose decisions may be further appealed to the Federal Administrative Court ("*Bundesverwaltungsgericht*") for final adjudication.

On average, civil cases before the courts of first instance take about eight to 10 months; appellate cases last another six to 10 months or more, depending on the court and individual federal state. Complex building disputes with comprehensive expert opinions usually take considerably longer than other proceedings. Furthermore, the evidence presented by the parties is of decisive importance. For example, according to survey statistics, 100 additional pages of presentation lead to an extension of 2.7 months in the length of the proceedings. Problems in finding a date for an oral hearing may further delay the process by 1.2 months on average.

4.6 Where the contract provides for court proceedings in a foreign country, will the judgment of that foreign court be upheld and enforced in your jurisdiction? If the answer depends on the foreign country in question, are there any foreign countries in respect of which enforcement is more straightforward (whether as a result of international treaties or otherwise)?

Judgments from other Member States of the European Union are automatically recognised in Germany and can be directly enforced (since the abolition of the so-called enforceability declaration procedure). The same applies to non-EU countries (third countries) with which Germany has entered into multi- or bilateral agreements on the direct enforcement or simplified recognition of foreign judgments. If no such agreements exist, a so-called exequatur procedure must be conducted in order to approve foreign judgments or arbitral awards for enforcement in Germany. This is the case for third countries such as the USA, China and Turkey, with whom no such treaty has been agreed.



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1 Making Construction Projects

1.1 What are the standard types of construction contract in your jurisdiction? Do you have: (i) any contracts which place both design and construction obligations upon contractors; (ii) any forms of design-only contract; and/or (iii) any arrangement known as management contracting, with one main managing contractor and with the construction work done by a series of package contractors? (*NB* For ease of reference throughout the chapter, we refer to “construction contracts” as an abbreviation for construction and engineering contracts.)

The most common types of contracts used in Greece for private construction work are: a) Measurement Contracts; b) Design-Build Contracts (DB); c) Design-Bid-Build Contracts; and d) Construction Management Contracts (CM).

In public works, Design-Build Contracts are very commonly used as it is also common practice regarding the construction agreements used for concession contracts that the central government and/or local authorities award them.

1.2 How prevalent is collaborative contracting (e.g. alliance contracting and partnering) in your jurisdiction? To the extent applicable, what forms of collaborative contracts are commonly used?

No collaborative contract is *per se* used in Greece. Employers would only enter into joint venture agreements with Contractors under the same entity in major concession projects. In construction agreements, partnering is usually found in Contractor consortia, as the cooperation of multiple Contractors with the intent to construct all or a part of the project together. Each Contractor is jointly and severally liable to the Employer, but the Employer is not a party in such arrangements.

1.3 What industry standard forms of construction contract are most commonly used in your jurisdiction?

Industry standard forms are not used in Greece. Bespoke contracts are used in public projects, in accordance with the EU Public Procurement Directives. However, these contracts are standard and are published by the contracting authorities. International Standard forms of contract (by the International Federation of Consulting Engineers (FIDIC)) are used only in specific private contracts (e.g. hospitality).

1.4 What (if any) legal requirements are there to create a legally binding contract (e.g. in common law jurisdictions, offer, acceptance, consideration and intention to create legal relations are usually required)? Are there any mandatory law requirements which need to be reflected in a construction contract (e.g. provision for adjudication or any need for the contract to be evidenced in writing)?

Construction contracts are works contracts, either under civil law or when tendered by a public authority under public law. In the case of private contracts, all agreements for works are entered into by offer and acceptance by two parties: the Contractor that is to provide the works and the Employer that will provide the agreed-upon remuneration (Art. 681 GCC). The parties must have the capacity to perform legal acts (Art. 127 GCC). The works contract is an informal agreement; nonetheless, the contracting parties can opt for a written format. The parties may include any terms they see fit in the agreement, as long as they do not violate the principles of good faith and fair trade (Arts 178 and 281 GCC).

In the case of public contracts, the process is formal and the freedom to contract is restricted by the nature of the contract. According to Public Procurement Law No. 4412/2016, which incorporates the EU Public Procurement Directives into the Greek legal system, the most frequently used procedures for the award of public contracts (works, supply of goods or services) are the open procedure (Arts 27 and 264 of the Public Procurement Law) and the restricted procedure (Arts 28 and 265 of the Public Procurement Law). Moreover, less commonly used procurement procedures are a) the competitive procedure with negotiations (Art. 29 of the Public Procurement Law), b) the negotiated procedure without prior publication (Arts 32 and 269 of the Public Procurement Law), c) the competitive dialogue (Arts 30 and 267 of the Public Procurement Law), d) the innovation partnership (Arts 31 and 268 of the Public Procurement Law), e) the direct award to a single entity as regards contracts of a project value up to €20,000 (Arts 118 and 328 of the Public Procurement Law), and f) a brief informal tendering procedure for contracts of a project value up to €60,000 (Arts 117 and 327 of the Public Procurement Law). As a rule, the contracting authorities are prohibited from treating the participating economic entities with discrimination and must contract with the economic operator that submits the most economically advantageous offer. Participation in public contracts is restricted to economic operators that meet certain technical and financial criteria set out by the contracting authorities. In exceptional cases, the authorities may opt for a specific contractual entity that best serves the public interest. The essential elements of a procurement procedure (e.g. procurement

documents, requests for participation, confirmation of interest, tenders and agreements) are mandatorily in writing and, recently, by electronic means.

1.5 In your jurisdiction please identify whether there is a concept of what is known as a “letter of intent”, in which an employer can give either a legally binding or non-legally binding indication of willingness either to enter into a contract later or to commit itself to meet certain costs to be incurred by the contractor whether or not a full contract is ever concluded.

The “*letter of intent*” is a concept recognised by Greek law, which indeed outlines all of the important points of the contract. Although indicative of the interest of a party to the contract, it is not legally binding. It is used to describe and may thus prove the key points of a negotiation or may be used as an invitation to the other party to submit an offer.

1.6 Are there any statutory or standard types of insurance which it would be commonplace or compulsory to have in place when carrying out construction work? For example, is there employer’s liability insurance for contractors in respect of death and personal injury, or is there a requirement for the contractor to have contractors’ all-risk insurance?

In private contracts, insurance is not obligatory by law. Nonetheless, the parties might agree to it, in order to mitigate the risk taken by the Contractor, and it may be for the works, site, employees, materials, etc.

In public contracts, according to Art. 144 of the Public Procurement Law, the designer, the Contractor and the technical consultant are obliged to insure the design, the construction of the project and the technical consultancy services, respectively, against any risk, including cases of *force majeure*. Until the adoption of the decision of the Minister of Infrastructure, Transport and Networks on the issues of insurance, projects whose budget, excluding VAT, exceeds the amount of €500,000 are obligatorily insured.

1.7 Are there any statutory requirements in relation to construction contracts in terms of: (a) labour (i.e. the legal status of those working on site as employees or as self-employed sub-contractors); (b) tax (payment of income tax of employees); and/or (c) health and safety?

The following statutory requirements apply:

- a) The Employer has the same legal obligations towards building workers as the Contractor regarding payment and social security contributions. A signed employment contract is obligatory for all individuals employed for the project.
- b) The income taxes of the employed individuals are not the responsibility of the Contractor or the Employer.
- c) All businesses located in Greece are obliged under Greek Law No. 3850/2010, applicable to projects in general, to hire a technical security specialist. If at least 50 employees work for them, they also have to hire an occupational physician. All necessary measures need to be taken so that health and safety rules are applied at the workplace. These measures need to be announced to both the employees’ representatives and the Labour Inspectorate. The Employer is responsible for keeping a registry of all work-related accidents, of which the Labour Inspectorate is to be notified.

For construction works with private construction contracts carried out in locations with a population over 10,000, with a surface area over 1,000 m³ and a mandatory licence to execute, the Contractor or Sub-Contractors are responsible for keeping an official safety measures diary, that is kept within the construction grounds (Art. 8 of Law No. 1396/1983). In public construction contracts, the economic operator is obligated to keep a constructions log, which includes the labour hours, the materials and heavy equipment used throughout the day, the work-site injuries, the weather conditions and the Sub-Contractor information (Art. 146 of the Public Procurement Law).

1.8 Is the employer legally permitted to retain part of the purchase price for the works as a retention to be released either in whole or in part when: (a) the works are substantially complete; and/or (b) any agreed defects liability period is complete?

Both in private and public contracts, the Employer may retain part of the purchase price for the works as a retention. The Employer usually retains the amount of the letter of guarantee during the period of guarantee between the temporary and the final acceptance of the project, and releases it after its final acceptance.

1.9 Is it permissible/common for there to be performance bonds (provided by banks and others) to guarantee the contractor’s performance? Are there any restrictions on the nature of such bonds? Are there any grounds on which a call on such bonds may be restrained (e.g. by interim injunction); and, if so, how often is such relief generally granted in your jurisdiction? Would such bonds typically provide for payment on demand (without pre-condition) or only upon default of the contractor?

Performance bonds are standard practice in construction agreements. These bonds might be on demand or provide for payment upon default of the Contractor. Both options are available but usually bonds are on demand. However, in case of calling the bonds without real cause, the courts may restrain the action and order an injunction which is not uncommon.

According to the provisions in Art. 72 of the Public Procurement Law, the contracting authorities require the participating economic entities to provide:

- a) A bid bond, the amount of which may not exceed 2% of the estimated value of the contract not including options rights and extension of the contract, excluding VAT. The bid bond must be valid for at least 30 days after the expiration of the term of validity of the tender as specified in the contract documents. Before the end of the tender, the contracting authority may ask the tenderer to extend the term of validity of the tender and of the bid bond. The bid bond is returned to the Contractor upon presentation of the good performance guarantee.
- b) A good performance guarantee for a project value over €20,000, the amount of which is set at 5% of the value of the contract, excluding VAT, and is deposited before or at the signing of the contract. A good performance guarantee covers in full the implementation of all the contractual terms and any claim by the contracting authority or the Employer against the Contractor and are released on final acceptance of the works (i.e. following the lapse of the guarantee period commencing with the provisional acceptance of the works).

- c) A good performance guarantee of the framework agreement, the amount of which is set at 0.5% of the value of the framework agreement, excluding VAT.
- d) An advance payment bond, in case of an advance payment, for an amount equal to the advance payment received. The advance payment and the advance payment bond cannot be used for expenses not related to the contract.

If provided in the contract documents, contracting authorities may require tenderers to provide a good functioning guarantee to remedy the defects that arise or the damage caused by malfunctioning of the works or goods during the period of the good functioning guarantee. The amount of the guarantee is stipulated in the contract documents at a specified amount.

These guarantees are issued by credit or financial institutions or insurance undertakings legally operating in the Member States of the European Union or the European Economic Area or in the GPA Member States and have the right to, in accordance with the applicable provisions. They may also be issued by the ETAA, TSMEDE or be provided with a note of deposit with the Consignment Deposits and Loans Fund. Moreover, there are specific provisions for guarantees in public works contracts in Art. 72 par. 6 of the Public Procurement Law.

1.10 Is it permissible/common for there to be company guarantees provided to guarantee the performance of subsidiary companies? Are there any restrictions on the nature of such guarantees?

The concept of company guarantees is used in Greece to bolster the financial credibility of their subsidiaries and to secure the performance of that party's obligations under the contract. There are no restrictions to them. They create joint liability with the parent company and may even be provided in bonds.

1.11 Is it possible and/or usual for contractors to have retention of title rights in relation to goods and supplies used in the works? Is it permissible for contractors to claim that, until they have been paid, they retain title and the right to remove goods and materials supplied from the site?

A "*retention of title*" clause gives permission to retain ownership over goods and materials supplied, until such time as certain conditions are met, usually full payment, thus providing a form of security against the Employer's default or insolvency. Further, after the completion of the project the Contractor may retain, as legal collateral, the personal property of the Employer that they have built or repaired and that is within their possession (Art. 695 GCC).

In the case of public contracts, the Contractor may usually request for adequate compensation, via a notice of default, if they have not yet received payment (Art. 137 of the Public Procurement Law) and it is not common practice that the goods and supplies are retained.

2 Supervising Construction Contracts

2.1 Is it common for construction contracts to be supervised on behalf of the employer by a third party (e.g. an engineer)? Does any such third party have a duty to act impartially between the contractor and the employer? If so, what is the nature of such duty (e.g. is it absolute or qualified)? What (if any) recourse does a party to a construction contract have in the event that the third party breaches such duty?

Public construction contracts in Greece are supervised by the

Employer's agents, the Supervising Authority according to Art. 136 of the Public Procurement Law. Supervision is not impartial but represents the Employer's rights, acting on his behalf while performing contract management duties. Supervision includes measurement costing and quality control of the project. Further, Art. 128 of the Public Procurement Law refers to the possibility of outsourcing of services by experts for the design and execution of major projects.

In major private construction projects, the supervision is generally conferred on independent third parties, recruited directly by the Employer. These engineers undertake tasks such as monitoring the entire process which has to be in line with the contractual terms and technical requirements and comply with the legislation. Such engineers may act to some extent impartially when acting as first-level decision-makers on Contractors' claims.

The concept of an "*Engineer*" as described by FIDIC does not exist in Greek law. However, in large-scale concession contracts, supervision might be essential.

2.2 Are employers free to provide in the contract that they will pay the contractor when they, the employer, have themselves been paid; i.e. can the employer include in the contract what is known as a "pay when paid" clause?

"Pay when paid" clauses are permitted under Greek law. However, these clauses should be reasonable and should not violate the principles of good faith and fair practice; otherwise, they cannot be enforced.

2.3 Are the parties free to agree in advance a fixed sum (known as liquidated damages) which will be paid by the contractor to the employer in the event of particular breaches, e.g. liquidated damages for late completion? If such arrangements are permitted, are there any restrictions on what can be agreed? E.g. does the sum to be paid have to be a genuine pre-estimate of loss, or can the contractor be bound to pay a sum which is wholly unrelated to the amount of financial loss likely to be suffered by the employer? Will the courts in your jurisdiction ever look to revise an agreed rate of liquidated damages; and, if so, in what circumstances?

Liquidated damages for a delay to completion, although a principle of common law, is recognised under Greek law in the sense of the penalty clause, where the liable party must pay to the other party a particular and reasonable amount for delay (Arts 404–407 GCC). Penalty clauses should be seen as flat-rate remuneration in the sense that the parties agree in advance that a fixed sum that corresponds approximately to the damage will be paid by the Contractor to the Employer in the event of particular breaches, such as late completion, without requiring proof of damage.

The works contract, as stated above, is based on the freedom to contract and therefore the parties hold the right to agree to any terms they see fit, as long as these provisions do not violate or oppose the principles of good faith and fair practice. Liquidated damages, although a principle of common law, can be agreed under the freedom to contract.

If the Employer can prove that the loss he suffered from a delay to completion exceeds the amount of the penalty clause, then he may only claim as compensation the excess amount beyond the amount of the penalty clause (Art. 406 par. 2 and Art. 407 par. 2 GCC), whereas when the Employer does not prove damage or proves less damage than the amount of the penalty clause, if he requests the clause, he will not have a claim for damages.

The court will take into consideration the contractual agreement of the parties but will also estimate the real economic damage done to the party and alter the agreed amount, if it is rendered unjust.

In public contracts, if the contracting authorities have not fulfilled their contractual obligations in a timely manner, they are obliged to afford the Contractor adequate compensation, equal to the material damages they have sustained (Art. 137 of the Public Procurement Law). Moreover, Art. 148 of the Public Procurement Law provides for specific penalty clauses in case of delays due to the Contractor.

3 Common Issues on Construction Contracts

3.1 Is the employer entitled to vary the works to be performed under the contract? Is there any limit on that right?

In private contracts, variation of the works can be negotiated by the parties in compliance with the principles of good faith and fair trade and to the extent that each variation cannot be considered a new project (quantity/price ratio) for which a new contract has to be drafted.

In public contracts, the project is executed according to the designs. If new and unexpected works are deemed essential by the managing authorities, then a new complementary contract may be signed between the parties. The new works must be technically necessary to the completion of the main project. The total amount of these new contracts, including the fee for the completion of the designs required for additional works, shall not exceed 50% of the value of the original contract. For the determination of the unit value of the works of the new complementary contract, the price of the original contract shall be taken into consideration, and the value for these additional works is provided for in Art. 156 of the Public Procurement Law.

According to Art. 156 of the Public Procurement Law, there is a possibility for amendments to the contract without any increase in value a) through the budget of unforeseeable expenses included in the original contract which concerns, in particular, expenses arising from obvious omissions or errors in the measurement of the design or from construction requirements which become necessary for the functionality of the project, and b) through a reduction of the number of works (as a result, the amount saved may be used to carry out other works of the same contract).

Moreover, according to Art. 155 of the Public Procurement Law, if there is a necessity for additional unforeseen works, their construction may be approved by the managing authority. The project may not exceed 15% of the agreed price.

3.2 Can work be omitted from the contract? If it is omitted, can the employer carry out the omitted work himself or procure a third party to perform it?

As it is possible for the parties to add work, it is acceptable for certain works to be omitted from the agreement, with the necessary adjustment of the agreed payment. These alterations, though, cannot result in a substantial change of the nature and/or size of the contract.

As already mentioned in the answer to question 3.1, works can be omitted from the contract in order to spare expenses for additional works of the same contract only if a) this is explicitly provided for in the contract and the tender specifications, b) there is no modification of the basic construction and design of

the project as described, c) the completeness, quality and functionality of the project is not affected, d) the amount spared is not used to pay for new works that were not in the original contract, and e) the amount spared does not exceed, cumulatively, 10% of the cost of the original contract value, excluding VAT, revision of prices and unforeseen costs (Art. 156 of the Public Procurement Law).

3.3 Are there terms which will/can be implied into a construction contract (e.g. a fitness for purpose obligation, or duty to act in good faith)?

Terms such as the fit for purpose obligation or duty to act in good faith are not implied terms; on the contrary, they are part of the work under Greek law.

Especially in public contracts, the principles of good faith and common practice (Arts 200 and 288 GCC) shall apply to the interpretation and execution of the contract. These clauses are applied under very strict conditions by the courts, which may adjust the obligations of the parties when it is required by good faith and common practice, and, in particular, when there are unforeseeable conditions that make the obligation of a party unreasonable exceeding the risk assumed.

3.4 If the contractor is delayed by two concurrent events, one the fault of the contractor and one the fault or risk of his employer, is the contractor entitled to: (a) an extension of time; and/or (b) the costs arising from that concurrent delay?

In principle, if there is a concurrent delay the Contractor is entitled to an extension of time for such time affected by Employer's fault. Regarding the costs arising from that concurrent delay, this will be a matter of contributory fault in the sense that the court would evaluate which part of the delay is caused by the Contractor.

3.5 Is there a time limit beyond which the parties to a construction contract may no longer bring claims against each other? How long is that period and when does time start to run?

Generally, the contractual liability limitation period is 20 years (Art. 249 GCC), except for a five-year liability period for certain claims, such as the Contractor's entitlement to payment (Art. 250 GCC).

The period of limitation for the Employer's claims due to latent defects is 10 years with regard to immovable constructions, and six months with regard to movables (Art. 693 GCC). (Latent defects are defects which were not apparent and which a reasonable inspection would not have revealed during the defects liability period.)

In public contracts, after the final acceptance of the project, the Contractor is liable under the provisions of the Civil Code. In case of special projects, tender specifications may specify additional responsibilities or obligations of the Contractor after final acceptance. Final acceptance is the starting point for the limitation period of the Contractor's claims from the contract which have not already been time-barred, in accordance with more specific provisions of the Public Procurement Law (Art. 172 of the Public Procurement Law).

Further, any of the Contractor's rights deriving from the execution of the contract have a general four-month limitation period (Art. 173 of the Public Procurement Law).

3.6 Which party usually bears the risk of unforeseen ground conditions under construction contracts in your jurisdiction?

Generally, in standard contracts, responsibility for unforeseen ground conditions rests with the party providing the design, usually the Employer, except for Design-Build Contracts where the risk is carried by the Contractor.

Under Greek law, when totally unforeseen underground conditions change the parties' agreement and, as a result, the parties' obligations are untenable, the court can rule the termination of the contract and the reasonable reimbursement of the parties (Arts 288 and 388 GCC).

3.7 Which party usually bears the risk of a change in law affecting the completion of the works under construction contracts in your jurisdiction?

Both in private and public construction contracts, the party who bears the risk of a change in law that can affect the implementation schedule of the works is usually the Employer.

3.8 Which party usually owns the intellectual property in relation to the design and operation of the property?

The party who owns copyright in relation to the design and operation of the property is the designer. The financial rights and the rights to exploit and use the materials subject to intellectual property are transferred to the Employer.

3.9 Is the contractor ever entitled to suspend works?

The Contractor has the right to suspend works if the fulfilment of part of the agreement from the Employer's side is overdue – in particular, when payment is overdue (partial or final payment) – and is obliged to suspend the works by an order of the Employer.

3.10 Are there any grounds which automatically or usually entitle a party to terminate the contract? Are there any legal requirements as to how the terminating party's grounds for termination must be set out (e.g. in a termination notice)?

If a contracting party has not fulfilled their contractual obligations and refuses to do so, or is unable to do so, then the other party may terminate the agreement, if such an action is included in the contract (Arts 686 and 383 GCC).

In public contracts, the Contractor may be disqualified, and the contract will be terminated, if they do not fulfil their contractual obligations, or do not abide by the written directions of the Supervising Authority (Art. 160 of the Public Procurement Law). Additionally, the Contractor may terminate the contract and discontinue all works a) if the project has not commenced for a period longer than three months due to the fault of the managing authority, b) if the managing authority or Employer decides to suspend the project for a period longer than three months, c) if there is an order of no payment, or d) if the delay in works is overdue with no fault of the Contractor (Art. 161 of the Public Procurement Law).

3.11 Do construction contracts in your jurisdiction commonly provide that the employer can terminate at any time and for any reason? If so, would an employer exercising that right need to pay the contractor's profit on the part of the works that remains unperformed as at termination?

It is common for contracts to provide for termination for convenience and arrange parties' rights and obligations thereof.

According to Art. 700 GCC, the Employer has the right to terminate for convenience at any time until the completion of the project. In case of termination, the Contractor is entitled to the agreed remuneration, after the deduction of the cost the Contractor was spared due to rescindment of the contract, or any further economic obligations of the Contractor towards the Employer.

In public contracts, the contracting authorities may unilaterally terminate a public contract solely for the reasons provided for in Arts 133 and 338 of the Public Procurement Law.

3.12 Is the concept of *force majeure* or frustration known in your jurisdiction? What remedy does this give the affected party? Is it usual/possible to argue successfully that a contract which has become uneconomic is grounds for a claim for *force majeure*?

Force majeure is a recognised concept in the Greek legal system. The parties may contractually agree that, in the case of *force majeure*, they will attempt to remedy the situation to the extent reasonably practicable, keep the other parties regularly informed on the progress and resume the performance of their obligations within a reasonable time or agree that an unforeseen event shall lead to the termination of the contract.

The affected party is entitled to receive adequate compensation, or even withdraw from the contract if the situation is not rectified within the given timeframe (Art. 380 GCC).

In public contracts, until final acceptance, the Contractor bears the risk of damage unless they are due to the fault of the managing authority. Exceptionally, for work-related damages resulting from *force majeure*, the Contractor is entitled to damages proportionate to the loss (Art. 157 of the Public Procurement Law).

3.13 Are parties, who are not parties to the contract, entitled to claim the benefit of any contractual right which is made for their benefit? E.g. is the second or subsequent owner of a building able to claim against the contractor pursuant to the original construction contracts in relation to defects in the building?

The mere fact that a contractual agreement may benefit a third party does not in of itself extend any rights to them. There must be a specific and beyond-any-doubt understanding within the contract, in which the Contractor will assume certain responsibilities towards a third entity (Art. 410 GCC). It is then the third party which obtains the right to claim a certain benefit for themselves.

3.14 On construction and engineering projects in your jurisdiction, how common is the use of direct agreements or collateral warranties (i.e. agreements between the contractor and parties other than the employer with an interest in the project, e.g. funders, other stakeholders, and forward purchasers)?

Direct agreements and collateral warranties are not provided for in Greek construction contracts.

3.15 Can one party (P1) to a construction contract, who owes money to the other (P2), set off against the sums due to P2 the sums P2 owes to P1? Are there any limits on the rights of set-off?

According to the provisions of Art. 440 GCC, the set-off of a party's claim is valid and can be made either out of court or as part of a court procedure. According to Art. 152 par. 11 of the Public Procurement Law, the Employer may set off his liquidated claims against the Contractor arising from the execution of other projects and up to 20% of each certification of the executed project.

3.16 Do parties to construction contracts owe a duty of care to each other either in contract or under any other legal doctrine? If the duty of care is extra-contractual, can such duty exist concurrently with any contractual obligations and liabilities?

The parties owe a duty of care in the sense that various contractual obligations are to be construed in accordance with good faith and business ethics principles. Further, there may be implied obligations arising from good faith. In both circumstances, such obligations may be obligations of care.

3.17 Where the terms of a construction contract are ambiguous, are there rules which will settle how that ambiguity is interpreted?

In case the terms of a construction contract are ambiguous, according to the provisions of the GCC, the rules on the interpretation of contracts apply. These rules stipulate that contracts shall be interpreted as required by good faith, taking into account common practice.

3.18 Are there any terms which, if included in a construction contract, would be unenforceable?

Terms in the contract that are opposed to the principles of good faith and fair trade (Arts 178, 179 and 281 GCC) would be rendered void. In addition, any agreement which breaches a statutory provision would be unenforceable.

3.19 Where the construction contract involves an element of design and/or the contract is one for design only, are the designer's obligations absolute or are there limits on the extent of his liability? In particular, does the designer have to give an absolute guarantee in respect of his work?

In construction contracts where there is the element of design, designers do not necessarily have absolute obligations. On the contrary, they can limit liability only for (simple) negligence and usually up to the amount of their fee.

3.20 Does the concept of decennial liability apply in your jurisdiction? If so, what is the nature of such liability and what is the scope of its application?

See the answer to question 3.5 above.

4 Dispute Resolution

4.1 How are construction disputes generally resolved?

Construction disputes in Greece can be resolved through litigation or through mediation or arbitration. Generally, disputes are resolved by the courts where the Greek Civil Procedure Code (GCPC) is applicable. The GCPC also provides other mechanisms (not commonly used) such as a) judicial settlement prior to the mediation (Art. 209 *et seq.*), b) out-of-court dispute settlement (Art. 214A), and c) judicial mediation (Art. 214B).

There is limited use of arbitration which can be carried out either in accordance with Art. 867 *et seq.* GCPC (national arbitration) or Law No. 2735/1999 and the respective transnational rules in case of international arbitration.

There is also the alternative method of mediation under Law No. 4512/2018 concerning mediation in civil and commercial matters, which does not apply to judicial mediation as governed by the GCPC.

In public contracts, pre-contractual disputes in tenders with a budget over €60,000 are resolved through a two-stage administrative and judicial process.

Stage 1: Any interested party having a legitimate interest in being awarded a specific construction contract which suffers a loss caused by an act or omission of the contracting authority in breach of European Union law or domestic law will have to file an application for review before the Authority for Review of Pre-Judicial Petition (AEPP) challenging this act or omission (Arts 346 and 360 of the Public Procurement Law). The filing of the application for review is a pre-condition for the exercise of legal remedies against the acts or omissions of the contracting authorities.

The tenderer may also seek for interim measures to be granted by the AEPP.

Moreover, the AEPP may annul the executed contract if it finds that:

- a) the contracting authority has awarded the contract without prior publication of a notice in the Official Journal of the European Union where necessary; or
- b) if the standstill obligation was not respected (Art. 368 of the Public Procurement Law).

Stage 2: Pursuant to Art. 372 of the Public Procurement Law, both the tenderer and the contracting authority may challenge the rulings issued by the AEPP with an application for suspension and an application for annulment before the competent Administrative Court of Appeal.

In case the illegal act or omission of the contracting authority has been annulled either by the AEPP or the court, the suffering tenderer is entitled to file an action for damages (Art. 373 of the Public Procurement Law).

A similar procedure by a formal two-stage dispute resolution mechanism is applied for disputes from the execution of public contracts (Arts 174 and 175 of the Public Procurement Law).

4.2 Do you have adjudication processes in your jurisdiction (whether statutory or otherwise) or any other forms of interim dispute resolution (e.g. a dispute review board)? If so, please describe the general procedures.

There is no such process in the Greek legal system.

4.3 Do the construction contracts in your jurisdiction commonly have arbitration clauses? If so, please explain how, in general terms, arbitration works in your jurisdiction.

In public contracts, arbitration may be agreed upon by parties and constitutes a clause within the contract (Art. 176 of the Public Procurement Law), but its use is not common. These arbitration clauses mainly provide for proceedings under international arbitration rules.

4.4 Where the contract provides for international arbitration, do your jurisdiction's courts recognise and enforce international arbitration awards? Please advise of any obstacles (legal or practical) to enforcement.

International arbitration awards can be enforced in Greece irrespective of the country where they have been issued.

According to Arts 903, 905 and 906 GCPC, a foreign arbitral award may be enforced in Greece. In any case, the regulations set forth by International Conventions and in particular the 1958 New York Convention (the NYC implemented by Law Decree No. 4220/1961) prevail over the GCPC. Moreover, Art. 36 of Law No. 2735/1999 "Law on International Arbitration", which regulates international arbitration conducted in Greece, provides that foreign arbitral awards are to be enforced in Greece under the NYC.

Pursuant to Art. IV NYC, the party who applies for recognition and enforcement of a foreign arbitral award has to submit a series of documents.

Recognition and enforcement of a foreign arbitral award may be refused by Greek courts in accordance with Art. V NYC. Under this article, a foreign award will not be enforced in Greece if the dispute between the parties cannot be subject to settlement by arbitration under Greek law (point 2a) and if it violates Greek *ordre public* (point 2b). Further, a foreign award will not be enforced if the arbitration agreement was invalid under its law or the law of the country in which the arbitral award was issued (point 1a), if the parties were not capable of entering into an arbitration agreement (point 1a), if there is a breach of the rules governing due process of the arbitration (point 1b), if the foreign award surpasses the scope of the arbitration agreement (point 1c), if the composition of the Tribunal did not comply with the agreement of the parties or the applicable law (point 1d) and if the award is not final and conclusive (point 1e). The burden of proving all of the above shall rest on the defendant.

4.5 Where a contract provides for court proceedings in your jurisdiction, please outline the process adopted, any rights of appeal and a general assessment of how long proceedings are likely to take to reduce: (a) a decision by the court of first jurisdiction; and (b) a decision by the final court of appeal.

In private contracts, cases related to the Contractor's remuneration are brought before the court of first instance according to the special procedure of labour disputes. The process commences with the filing of a lawsuit with the court of first instance. The court then follows a process for the parties to file their petitions and necessary documents and affidavits that would better prove their claims. After a substantial period of time that can be up to two years, the court holds a hearing and then the judge publishes their final judgment over the next six months. This judgment may be appealed by the losing party, within 30 days from the day after the service of the court judgment by the opposing party.

There is a court hearing held by the court of second instance and the court judgment is published after some months. Finally, the losing party can discuss the case for the last time in front of the Supreme Court of Greece and this decision is final and obligatory for both parties. The entire process might take more than six years.

As already mentioned in the answer to question 4.1, according to Art. 372 of the Public Procurement Law, any interested party having a legitimate interest may challenge the rulings issued by the AEPP with an application for suspension and an application for annulment before the competent Administrative Court of Appeal of the seat of the contracting authority. The competent Administrative Court of Appeal decides irrevocably. Disputes arising a) from the award of public works concession contracts implemented as Public Private Partnerships, and b) from the award of public contracts with a budget over €15,000,000, including VAT, are heard by the State Council. The filing of the application for annulment is not a pre-condition for the exercise of the application for suspension. The application for suspension shall be filed with the competent court within 10 days of the notification or full knowledge of the decision on the preliminary ruling by the AEPP and shall be discussed no later than 30 days after its filing. The time limit for the application for annulment is interrupted upon the filing of the application for suspension and begins with the service of the relevant decision. The party who succeeded in suspending the execution of the contested ruling must bring before the competent court the application for annulment within 10 days of the service of this decision, otherwise the validity of the suspension will be automatically revoked. The hearing of the application for annulment is held within three months of the filing of the application. The application for suspension is admissible if it is probable that there is a breach of European Union law or national law and the suspension is necessary in order to remedy the adverse effects of that breach or to prevent damage of the applicant. However, the application may be refused if the negative consequences of its acceptance would be more serious than the benefit of the applicant. The decision on the suspension is issued within 20 days of the hearing of the application. The filing of the application for suspension prevents the conclusion of the contract unless the competent judge decides otherwise by issuing an interim injunction.

If the application for suspension is accepted, the institution which adopted the act whose enforcement is suspended may comply with the content of the decision and withdraw or amend the act. In that case, the trial of the application for annulment is abolished. If the interested party did not file or unsuccessfully file for the suspension and the contract was signed and executed before the application for annulment was discussed, the trial of the application for annulment is abolished, unless the party has a particular legitimate interest in the continuation of the proceedings. If the court annuls an act or omission of the contracting authority after the execution of the contract, the latter is not affected, unless the procurement procedure has been suspended prior to the conclusion of the contract by a decision of the AEPP or by a decision on the application for suspension or by an interim injunction. In such a case, the party concerned shall be entitled to claim compensation as referred to in Art. 373 of the Public Procurement Law.

According to Art. 175 of the Public Procurement Law, disputes deriving from public work contracts are brought to the Administrative Court of Appeal in the administrative district where the construction is taking place after the bringing of an appeal or an action. Prior to the bringing of an appeal before the administrative court, the interested party has to file a complaint within the meaning of Art. 174 of the Public Procurement Law,

otherwise the appeal is dismissed as inadmissible. In particular, for projects whose budget, excluding VAT, exceeds €500,000, the public hearing is held within six months at the latest. The decision shall be adopted as soon as possible. The losing party may appeal their case to the State Council and the hearing is held when the court deems the case ready for discussion. The decision might take up to a year to be published. If the execution of the contested decision will cause damage which would be difficult to repair, the State Council may order total or partial suspension of the execution of the contested decision at the request of a party.

4.6 Where the contract provides for court proceedings in a foreign country, will the judgment of that foreign court be upheld and enforced in your jurisdiction? If the answer depends on the foreign country in question, are there any foreign countries in respect of which enforcement is more straightforward (whether as a result of international treaties or otherwise)?

Under no circumstances can construction contracts provide for court proceedings in a foreign country.



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1 Making Construction Projects

1.1 What are the standard types of construction contract in your jurisdiction? Do you have: (i) any contracts which place both design and construction obligations upon contractors; (ii) any forms of design-only contract; and/or (iii) any arrangement known as management contracting, with one main managing contractor and with the construction work done by a series of package contractors? (NB For ease of reference throughout the chapter, we refer to “construction contracts” as an abbreviation for construction and engineering contracts.)

The construction industry in India does not subscribe to any standard form of construction contract; however, some of the commonly used forms include the suite of contracts published by the International Federation of Consulting Engineers (“FIDIC”), the Institution of Civil Engineers (“ICE”), and the model published by the Indian Institute of Architects (“IIA”). Governmental construction authorities, such as the National Highways Authority of India (“NHAI”), employ their own standard form contract as per their departmental requirements, particularly for public-private partnership projects. One standard FIDIC form extensively used in the Indian construction industry is the Plant and Design/Build Contract. Design-only contracts prevalent in India are largely inspired by the FIDIC Conditions of Contract for Plant and Design/Build (the FIDIC Yellow Book).

Besides the NHAI, several government departments such as the Public Works Department, Delhi Metro Rail Corporation, Indian Oil Corporation, National Building Construction Corporation, Central Public Works Department, etc. have their own standard form contracts.

Management contracts are executed in the form of Engineering, Procurement and Construction Management Contracts. As the name suggests, such contracts are executed between employers and contractors, wherein contractors are hired to holistically manage the completion of a construction project while overseeing developments regarding engineering, procurement and construction of a project.

1.2 How prevalent is collaborative contracting (e.g. alliance contracting and partnering) in your jurisdiction? To the extent applicable, what forms of collaborative contracts are commonly used?

Collaborative contracting is common in the real estate sector in India where the landowner and real estate developer enter into a joint development agreement. There are no settled forms

but usually the landowner provides the land and the developer undertakes the responsibility of obtaining the necessary approvals and undertakes the building/financial obligations.

1.3 What industry standard forms of construction contract are most commonly used in your jurisdiction?

See the answer to question 1.1.

1.4 What (if any) legal requirements are there to create a legally binding contract (e.g. in common law jurisdictions, offer, acceptance, consideration and intention to create legal relations are usually required)? Are there any mandatory law requirements which need to be reflected in a construction contract (e.g. provision for adjudication or any need for the contract to be evidenced in writing)?

The Indian law of contracts is codified (Indian Contract Act, 1872). It is largely based on English Common Law. For any binding contract to come into existence, there should be an agreement between two or more parties who are competent to contract, and the parties must have entered into the agreement with their free consent, for a lawful consideration and a lawful object. These requirements are mandated by the Act (Section 10 thereof). As with all other contracts, construction contracts must also satisfy the aforesaid requirements to be legally enforceable. Further, rudimentary requirements of a valid offer, followed by an acceptance of an offer, with the intention of entering into a legally enforceable agreement not void in law, are other essentials of a valid contract under the Act. As the Act provides, contracts need not be evidenced in writing, which similarly applies to all construction contracts.

1.5 In your jurisdiction please identify whether there is a concept of what is known as a “letter of intent”, in which an employer can give either a legally binding or non-legally binding indication of willingness either to enter into a contract later or to commit itself to meet certain costs to be incurred by the contractor whether or not a full contract is ever concluded.

The legal position in India as regards a “Letter of Intent” (“LOI”) is well settled and can be understood while referring to common law principles to the effect that an agreement to enter into an agreement does not create any legal relation between parties, nor is it legally enforceable before a court of law.

A LOI merely indicates a party’s intention to enter into a contract with the other party in the future. Normally, it is an

agreement to “enter into an agreement” which is neither enforceable nor does it confer any rights upon the parties. However, some aspects of a LOI may contain binding obligations, if so specifically provided therein. Thus, confidentiality, exclusivity of dealings and governing law/jurisdiction, amongst others, may create binding obligations. In certain circumstances, a LOI may be construed as a letter of acceptance of the offer resulting in a concluded contract between the parties. It largely depends on the intention of the parties to be drawn from the terms of the LOI, the nature of the transaction and other relevant circumstances. If parties have acted on a LOI (as if there is a binding obligation), it can be held as constituting a binding contract between them. In India, a binding contract can result from conduct alone.

1.6 Are there any statutory or standard types of insurance which it would be commonplace or compulsory to have in place when carrying out construction work? For example, is there employer’s liability insurance for contractors in respect of death and personal injury, or is there a requirement for the contractor to have contractors’ all-risk insurance?

The standard type of insurance policy opted by the employer, contractor or a sub-contractor separately or jointly is the Contractor’s All Risk Policy (“CAR Policy”). All major construction contract projects expressly provide for putting in place a CAR policy during the construction stage. Federal legislation requires any business, including construction projects, employing more than 10 people to procure registration under the Employees’ State Insurance Act, 1948 (“ESI Act”).

The ESI Act mandates every employer to provide for its worker’s insurance. The said Act covers both workers employed directly under an employer and through a contractor. The insurance procured by an employer/contractor under the mandate of the ESI Act covers contingencies such as maternity leave, sickness, temporary or permanent physical disablement, or death owing to the hazards of employment which may lead to loss of wages and earning capacity of an employee.

1.7 Are there any statutory requirements in relation to construction contracts in terms of: (a) labour (i.e. the legal status of those working on site as employees or as self-employed sub-contractors); (b) tax (payment of income tax of employees); and/or (c) health and safety?

The following are some of the statutory requirements which must be complied with:

- (a) **General Requirements:** As stated above, all construction contracts must satisfy the requirements of the Indian Contract Act, 1872 to be legally enforceable. There are no statutory requirements specifically in relation to construction contracts.
- (b) **Labour:** All employers and contractors are required to comply with the relevant labour legislation in force in India or in the state/city concerned. The onus of complying with such labour laws falls upon an employer or a contractor depending on the legislation. Labourers get their legal recognition from the definition of the word “workman” under the Industrial Disputes Act, 1947 (Federal legislation) which entitles them to various statutory benefits and fair treatment at the hands of their employer/contractor. Further, the Contract Labour (Regulation and

Abolition) Act, 1970 must be complied with by any principal employer/contractor who hires 20 or more contract labourers for an “establishment”. The said Act requires the principal employer to register its establishment in accordance with the Act, whereas all such contractors must obtain a licence from the authorised licensing authority specified in the Act. In order to regulate the condition of service of inter-state labourers, the Inter-State Migrant Workmen (Regulation of Employment and Conditions of Service) Act, 1979 requires all contractors who employ five or more inter-state migrant workmen to register themselves. It aims to protect and/or provide a migrant worker’s right to equal wages, displacement allowance, home journey allowance, medical facilities, etc. The Workmen’s Compensation Act, 1923 requires that compensation be paid to workers if injured in the course of employment. Under the Minimum Wages Act, 1948, the employer is required to pay the minimum wage rates as may be fixed by the relevant government. Further, the Payment of Wages Act, 1936, read with the Amendment Act, 2017, ensures that the employees receive wages on time and without any unauthorised deductions.

The Code on Wages, 2019 (“Wages Code”) passed by Parliament in August, 2019 (the provisions of which have not yet been notified by the Central Government) seeks to consolidate and replace four Acts: the Payment of Wages Act, 1936; Minimum Wages Act, 1948; Payment of Bonus Act, 1965; and Equal Remuneration Act, 1976. It extends to all establishments, employees and employers unless specifically exempt. The Code, *inter alia*, provides for a national floor rate for wages which is to be determined by the Central Government after taking into account the minimum living standards. The Code further provides for a review of the minimum wages at intervals not exceeding five years.

- (c) **Tax:** A person responsible for paying any sum to a contractor for carrying out any work (including supply of labour for carrying out any work) is required to, at the time of payment, deduct tax commonly known as Tax Deducted at Source (“TDS”) under Section 194C of the Income Tax Act, 1961. The Works Contract Tax is applicable to contracts for labour, work or service. Prior to 1 July 2017, the Central Government and State Government levied Service Tax and VAT, respectively, on works contracts. However, after the roll-out of the Goods and Services Tax (“GST”), works contracts (in relation to immovable property) are treated as supply of services and, at present, tax slabs range from 12% to 18%. In the first instance, tax is payable by the person supplying the services/goods. The Building and Other Construction Workers Welfare Cess Act, 1996, which applies to 10 or more building workers or other construction work, has been enacted for the welfare of construction workers, including regulating the workers’ safety, health, and other service conditions. A cess of 1% is collected from the employer on the cost of construction incurred.
- (d) **Health and Safety:** Social security legislation such as the Employee’s Compensation Act, 2009, ESI Act, Maternity Benefit Act, 1961, Payment of Gratuity Act, 1972, the Employees’ Provident Fund and Miscellaneous Provisions Act, 1952, and the Sexual Harassment at Workplace (Prohibition, Prevention and Redressal) Act, 2013, mandatorily apply to all employers and contractors hiring labourers or workmen in the construction industry.

1.8 Is the employer legally permitted to retain part of the purchase price for the works as a retention to be released either in whole or in part when: (a) the works are substantially complete; and/or (b) any agreed defects liability period is complete?

Yes. In construction contracts, provision for retaining part of the purchase price for the given situations is fairly common. Parties may also agree to deposit the purchase price in an escrow account to ensure a level playing field for both the employer and the contractor. The contract may provide that the employer, prior to completion of the works, releases the retention money provided the contractor furnishes an unconditional bank guarantee equivalent to the retention money.

1.9 Is it permissible/common for there to be performance bonds (provided by banks and others) to guarantee the contractor's performance? Are there any restrictions on the nature of such bonds? Are there any grounds on which a call on such bonds may be restrained (e.g. by interim injunction); and, if so, how often is such relief generally granted in your jurisdiction? Would such bonds typically provide for payment on demand (without pre-condition) or only upon default of the contractor?

Yes, performance bonds/performance guarantees are commonly provided for in construction contracts in India to provide security against failure of a contractor to perform its contractual obligations. Similarly, an employer may require company guarantees from parent companies against the duties and obligations of a subsidiary company involved in a construction contract.

The nature of restrictions that may apply to a performance guarantee will depend upon the wording of the terms of guarantee. A performance guarantee, in nature, is a contract between an employer and a guarantor, independent of the contract between an employer and a contractor. Therefore, unless otherwise provided, a guarantor shall be obliged to unconditionally honour a guarantee as and when called upon by the employer.

Normally, construction contracts require the contractor to furnish an unconditional performance bank guarantee to ensure timely and satisfactory performance by the contractor. The employer normally requires the contractor to keep the performance bank guarantee valid until the defect liability period is over or the completion certificate is issued. The beneficiary of the bank guarantee, i.e. the employer, must make a demand for payment under the bank guarantee, should a need so arise, before the expiry of the validity period stipulated in the bank guarantee. A demand made by the employer for payment after the validity period will not be honoured by the bank.

The Courts have held that in order to restrain the encashment of a bank guarantee there should be a strong *prima facie* case of fraud or special equities in the form of irretrievable injustice. Thus, commitments of banks must be honoured free from interference by the courts.

1.10 Is it permissible/common for there to be company guarantees provided to guarantee the performance of subsidiary companies? Are there any restrictions on the nature of such guarantees?

See the answer to question 1.9.

1.11 Is it possible and/or usual for contractors to have retention of title rights in relation to goods and supplies used in the works? Is it permissible for contractors to claim that, until they have been paid, they retain title and the right to remove goods and materials supplied from the site?

Yes, it is possible. Right to lien over goods arises from the contractor's right to be duly paid for the goods supplied to an employer. The existence of right of lien over goods, and the scope of such right, is determined by a contractual clause to that effect. Lien over goods whose ownership passes over to an employer on delivery to, or affixation on, a construction site may exist if contractually provided for. However, most construction contracts do not provide for the contractor's title rights to the goods and supplies made for the works.

2 Supervising Construction Contracts

2.1 Is it common for construction contracts to be supervised on behalf of the employer by a third party (e.g. an engineer)? Does any such third party have a duty to act impartially between the contractor and the employer? If so, what is the nature of such duty (e.g. is it absolute or qualified)? What (if any) recourse does a party to a construction contract have in the event that the third party breaches such duty?

Yes, construction contracts are commonly supervised by third parties in India who may be appointed by an employer in the role of either an architect or an engineer. The scope of their functions and duties is contractually defined.

Whilst the engineer or architect usually has a contractual duty to act impartially between the contractor and employer, in practice in government contracts, the engineer in particular often toes the line of the employer.

2.2 Are employers free to provide in the contract that they will pay the contractor when they, the employer, have themselves been paid; i.e. can the employer include in the contract what is known as a "pay when paid" clause?

Yes. Such clauses are valid under the Indian Contract Act, 1872.

2.3 Are the parties free to agree in advance a fixed sum (known as liquidated damages) which will be paid by the contractor to the employer in the event of particular breaches, e.g. liquidated damages for late completion? If such arrangements are permitted, are there any restrictions on what can be agreed? E.g. does the sum to be paid have to be a genuine pre-estimate of loss, or can the contractor be bound to pay a sum which is wholly unrelated to the amount of financial loss likely to be suffered by the employer? Will the courts in your jurisdiction ever look to revise an agreed rate of liquidated damages; and, if so, in what circumstances?

Yes. Stipulating a certain amount to be paid by a contractor to its employer as liquidated damages is permissible. Such damages are governed by Section 74 of the Indian Contract Act, 1872, which provides that if a sum is named in the contract as the

amount to be paid in case of such breach of contract, the party complaining of breach is entitled to receive the said amount, “whether or not actual loss is proved to have been caused”. Section 74 has been judicially interpreted and the following principles have been laid down:

- Only reasonable compensation can be awarded as liquidated damages.
- Notwithstanding a liquidated damages clause, the *factum* of damage or loss caused must be proved (the burden for which is on the claimant).
- The court must find the liquidated damages to be a genuine pre-estimate of the damages.
- The expression “whether or not loss is proved” in Section 74 has been interpreted to mean that if there is a possibility to prove actual damage or loss, such proof is required. Where, however, it is difficult or impossible to prove the actual damage or loss, the liquidated damages amount named in the contract, if it is found to be a genuine pre-estimate of the damage or loss, can be awarded.
- The proof of loss or damage may be circumstantial and the court does not look for arithmetical exactitude.
- The amount named in a contract serves as a ceiling or a cap on the sum which can be awarded and not the amount which will mechanically be awarded.

If parties have agreed to a genuine pre-estimated sum of money as liquidated damages, then they are deemed to have excluded their right to claim an unascertained sum of money as damages.

3 Common Issues on Construction Contracts

3.1 Is the employer entitled to vary the works to be performed under the contract? Is there any limit on that right?

Variations in the works to be performed under a construction contract may be made by an employer or an engineer employed for such works. If such variations are made, a contractor is entitled to seek additional payments for the same so far as such variations have been duly authorised by the employer/engineer-in-charge. However, such variations must not be of such a nature as to substantially alter the character of the contract in question and must be within the ability of the contractor to execute.

3.2 Can work be omitted from the contract? If it is omitted, can the employer carry out the omitted work himself or procure a third party to perform it?

Yes, works may be omitted from a construction contract by an employer or an engineer if there is an express term in the contract permitting omission. However, such omissions must not be made to deliberately deprive a contractor from its entitled share of works. The employer cannot omit the work on non-*bona fide* grounds (and have it carried out by someone else without the contractor’s consent).

3.3 Are there terms which will/can be implied into a construction contract (e.g. a fitness for purpose obligation, or duty to act in good faith)?

Yes. Indian law recognises use of both express and implied terms in a construction contract. While express terms are easily identifiable, implied terms must be read into a contract while examining the intention of the contracting parties. However,

such terms must not offend the intended commercial purpose of the contract as understood between the parties. While there is no agreed set of terms which can be implied in a construction contract, certain obligations are understood as impliedly binding on both the employer and the contractor. For example, a contractor is expected to perform its tasks while exercising a standard of care, and must provide such materials which are fit to be used for the stipulated works.

3.4 If the contractor is delayed by two concurrent events, one the fault of the contractor and one the fault or risk of his employer, is the contractor entitled to: (a) an extension of time; and/or (b) the costs arising from that concurrent delay?

The Indian position on concurrent delay is not certain. In situations where there are concurrent delays on the part of an employer and a contractor, an employer may rely upon them to substitute an extension of time for payment of any monetary damages to a contractor, whereas a contractor may rely upon them to defend against imposition of liquidated damages upon itself by an employer. Therefore, in cases of concurrent delays, a contractor would be entitled to an extension of time and not to compensation for any loss it may have suffered due to the delays (see: *De Beers UK Ltd v. Atos Origin IT Services UK Ltd* [2010] EWHC 3276 (TCC)). A contractor would be entitled to an extension of time for the period of delay caused by the relevant event notwithstanding the concurrent effect of the other event (see: *Walter Lilly & Co Ltd v. Mackay* [2012] EWHC 1773 (TCC)). Indian courts usually refer to and rely upon English cases.

3.5 Is there a time limit beyond which the parties to a construction contract may no longer bring claims against each other? How long is that period and when does time start to run?

The Limitation Act, 1963 governs a time period for filing a court action and also a claim before the arbitral tribunal. As per the said Act, the limitation period for the purpose of initiating a suit in relation to a breach of contract is three years from the date on which the breach occurs or the cause of action arises.

3.6 Which party usually bears the risk of unforeseen ground conditions under construction contracts in your jurisdiction?

It is for the parties to agree in the contract as to who shall bear the risk of unforeseen ground conditions. Construction contracts generally put all the risk on the contractor.

3.7 Which party usually bears the risk of a change in law affecting the completion of the works under construction contracts in your jurisdiction?

Most construction contracts provide for relevant stipulations for a change in law contingency. Generally, an employer bears the risk arising out of a change in law, and any delays resulting out of it can be condoned by granting an extension of time to the contractor. Section 64A of the Sale of Goods Act, 1930 provides that in the event of an increase or decrease in tax or the imposition of new tax in respect of goods after the making of any contract for the sale or purchase of goods, in the absence of any stipulation as to payment of such tax, any increase would entitle the seller to add the equivalent amount of the contract price and

the buyer would be liable to pay the increased sum to the seller. However, in case of a decrease in tax, the buyer would be entitled to deduct the equivalent amount of decreased sum from the contract price and the seller would be liable to pay that sum to the buyer. The provision is applicable to any duty of customs or excise on goods and to any tax on the sale or purchase of goods.

3.8 Which party usually owns the intellectual property in relation to the design and operation of the property?

Generally, a contract for service contains clauses so as to empower an employer to claim ownership over all intellectual property as may be created by an employee in the course of his employment. Indian law also provides for employment as an exception to an author's ownership over his intellectual property. Therefore, in the case of construction contracts, ownership of intellectual property in the form of design of concerned works should vest with the employer.

3.9 Is the contractor ever entitled to suspend works?

A contractor may suspend performance of its obligations under a construction contract on grounds provided for in the contract in accordance with its statutory right to do so under the Indian Contract Act, 1872. Occasions when a contractor may suspend performance include non-performance of the obligations or considerable delay by an employer, non-payment of dues for works performed, non-fulfilment of conditions upon which the performance is contingent, *force majeure*, etc.

3.10 Are there any grounds which automatically or usually entitle a party to terminate the contract? Are there any legal requirements as to how the terminating party's grounds for termination must be set out (e.g. in a termination notice)?

The Indian Contract Act, 1872 allows a party to rescind/terminate a contract in the event of breach by the other party, including refusal to perform or disabling himself from performing (Section 39 of the Act). Over and beyond the statutory grounds of breach recognised in the Act, parties may choose to provide contractual stipulations recognising events which would amount to breach of the contract to entitle the injured party to terminate the contract. A statutory or common law ground of breach need not be expressly provided in a contract; however, other instances of breach should be specified in the contract.

3.11 Do construction contracts in your jurisdiction commonly provide that the employer can terminate at any time and for any reason? If so, would an employer exercising that right need to pay the contractor's profit on the part of the works that remains unperformed as at termination?

No. Construction contracts usually specify events on the basis of which an employer can terminate the contract. In most cases, the contract provides for a cure period notice to be given by the employer prior to termination. If termination is for the employer's convenience, the contractor is usually entitled to termination payment and compensation. If the contract has been wrongfully terminated, the contractor is entitled to claim compensation. See also the answers to questions 3.10 and 3.18.

3.12 Is the concept of *force majeure* or frustration known in your jurisdiction? What remedy does this give the affected party? Is it usual/possible to argue successfully that a contract which has become uneconomic is grounds for a claim for *force majeure*?

The concept of a *force majeure* event is well recognised in the Indian legal system. The doctrine of frustration of contract is imbedded in Section 56 of the Indian Contract Act, 1872. In accordance therewith, a contract stands frustrated if the performance of an agreed set of obligations becomes impossible or unlawful, either before or after the conclusion of a contract. Section 56 of the Act thus recognises *force majeure* (or act of God) events as a ground for frustration of contracts. Frustration of a contract under Section 56 of the Act results in such a contract becoming void in law, and thus cannot be enforced. Therefore, a frustrated contract stands discharged and relieves the parties from performance of all underlying obligations. The Supreme Court in *Satyabrata Ghose v. Mugneeram Bangur & Co.*, AIR 1954, SC 44, *inter alia*, held that an untoward event or change of circumstance which totally upsets the very foundation upon which the parties have entered into their agreement, will amount to *force majeure*. However, an exception to Section 56 states that if frustration was within the reasonable contemplation of the promisor, or if the contract is frustrated due to acts attributable to the promisor, the promisee shall be entitled to compensation for any loss it suffers due to non-performance of the promisor's obligations under the contract.

However, Section 56 does not apply to instances of mere inconvenience, economic unfeasibility, or if performance of the contract has become more burdensome, but without impossibility.

In a fairly recent case, the Supreme Court in *Energy Watchdog v. CERC*, (2017) 14 SCC 80, held that *force majeure* clauses are to be narrowly construed. Further, where the parties have a specific *force majeure* clause in the agreement, the provisions of the Indian Contract Act, 1872 would not apply.

The recent COVID-19 outbreak has seen a spate of invocation of *force majeure* clauses and it is likely that the courts will lay path-breaking law on the subject in due course.

3.13 Are parties, who are not parties to the contract, entitled to claim the benefit of any contractual right which is made for their benefit? E.g. is the second or subsequent owner of a building able to claim against the contractor pursuant to the original construction contracts in relation to defects in the building?

Third parties cannot bring claims or enforce terms of a contract against a party to a contract. This principle emanates from the doctrine of "privity of contract", which confers rights and obligations arising out of a contract only upon parties to a contract. Therefore, in the landscape of construction law, a contractor cannot be subjected to claims from third parties to a construction contract. However, third parties are entitled to a remedy under tort law for injury suffered due to negligent acts of a contract. Therefore, a contractor may be subjected to claims under tort law for negligence.

3.14 On construction and engineering projects in your jurisdiction, how common is the use of direct agreements or collateral warranties (i.e. agreements between the contractor and parties other than the employer with an interest in the project, e.g. funders, other stakeholders, and forward purchasers)?

Collateral warranties or direct agreements are not usual in construction and engineering projects in India.

3.15 Can one party (P1) to a construction contract, who owes money to the other (P2), set off against the sums due to P2 the sums P2 owes to P1? Are there any limits on the rights of set-off?

Yes, parties in a construction contract can set off their claims and dues against each other. This can be done either by way of mutual negotiations and agreement, or through a proceeding before a court of law or in an arbitration proceeding. An instance for the latter would arise where parties disagree upon the amount due to either party. In such cases, a cross-claim is filed by the party who wishes to set off its claims against the amount it owes to the other party. Such cross-claims must be for a recognised sum and must be based on a legitimate claim against the other party.

3.16 Do parties to construction contracts owe a duty of care to each other either in contract or under any other legal doctrine? If the duty of care is extra-contractual, can such duty exist concurrently with any contractual obligations and liabilities?

The doctrine of “duty of care” originates from tort law and requires a person to exercise a standard of care while performing any act which could foreseeably cause harm to others. This duty extends to all such persons who, on a reasonable contemplation, can be expected to be affected by the acts of a person. Therefore, the doctrine of “duty of care” applies to all construction works performed by a contractor, and a liability for negligence may arise for any harm caused to persons who could foreseeably be affected by his acts.

3.17 Where the terms of a construction contract are ambiguous, are there rules which will settle how that ambiguity is interpreted?

Any ambiguity must be attempted to be resolved by resorting to well-recognised rules of contractual interpretation, such as the rule of literal interpretation, harmonious construction, giving effect to the intention of the parties, and resorting to an interpretation which upholds business efficacy of the contract. (These principles are to be applied in that order.) If the ambiguity sustains on the application of the said rules, the rule of *contra proferentem* may be resorted to.

3.18 Are there any terms which, if included in a construction contract, would be unenforceable?

The following terms or clauses shall be unenforceable in a construction contract:

- (a) clauses empowering an employer to unilaterally terminate a contract without any remedy to a contractor;
- (b) unilateral and substantial alteration of the character of a contract by adding/omitting obligations of a contractor;
- (c) clauses for payment of an unreasonable sum in the form of liquidated damages;
- (d) clauses absolutely restricting a party from enforcing his rights under or in respect of any contract;
- (e) clauses which limit the time within which a party may enforce his rights; and
- (f) any other clause which falls foul of the provisions of the Indian Contract Act, 1872.

3.19 Where the construction contract involves an element of design and/or the contract is one for design only, are the designer's obligations absolute or are there limits on the extent of his liability? In particular, does the designer have to give an absolute guarantee in respect of his work?

As regards a designer's contractual liability, the same shall be limited to the obligations owed by the designer towards other parties to the construction contract, such as the employer. Due to the application of the doctrine of privity of contract, the contractual liability of the designer would not extend to third parties.

As for a designer's liability in tort law, please see the response to question 3.13 above. Harm to third parties must have directly arisen out of the impugned negligence towards the design in question, and must have been reasonably foreseen as being caused to persons who may avail of the facility designed.

Any guarantee given by a designer under a construction contract would have relevance only against potential contractual claims for a defect in design; however, such a guarantee would not keep his liability under tort law at bay.

3.20 Does the concept of decennial liability apply in your jurisdiction? If so, what is the nature of such liability and what is the scope of its application?

No, the concept of decennial liability is not recognised in India. Defect liability clauses in construction contracts broadly cover such liability of the contractor. Liability under the defect liability clause is generally for a period of six or 12 months after completion of the project.

4 Dispute Resolution

4.1 How are construction disputes generally resolved?

There are multifarious ways of resolving disputes that are recognised in India. These include resolving disputes by way of court litigation, arbitration, mediation, conciliation, dispute resolution boards and judicial settlement. Arbitration is the most commonly used mechanism to resolve construction contract disputes.

4.2 Do you have adjudication processes in your jurisdiction (whether statutory or otherwise) or any other forms of interim dispute resolution (e.g. a dispute review board)? If so, please describe the general procedures.

In the absence of a statutory enactment to refer a payment dispute to adjudication, the adjudication process is subject to the parties' agreement. Generally, a clause containing the adjudication process would be part of the dispute resolution clause wherein parties would resolve disputes in the first instance through an adjudicator named in the contract. The contract would stipulate a time period within which the contractor may refer a decision of the engineer to the adjudicator. It would also stipulate the time limit within which the adjudicator must give his decision. If either party is aggrieved by the decision of the adjudicator, it may refer the dispute to arbitration within a stipulated time period failing which the adjudicator's decision will be final and binding.

4.3 Do the construction contracts in your jurisdiction commonly have arbitration clauses? If so, please explain how, in general terms, arbitration works in your jurisdiction.

One of the widely accepted means of dispute resolution in construction disputes is arbitration. The Arbitration and Conciliation Act, 1996 (“Arbitration Act”) is the governing law of arbitration in India. The Arbitration Act is essentially based on the UNCITRAL Model Law, 1985 and UNCITRAL Model Arbitration Rules, 1976. Broadly, the Act has two parts. Part I is an elaborate code providing for all arbitrations seated in India (domestic or international arbitrations). Part II provides basically for enforcement of foreign awards (see the response to question 4.4). India is an arbitration-friendly jurisdiction with a pro-arbitration Act and a good track record of enforcement for foreign awards.

4.4 Where the contract provides for international arbitration, do your jurisdiction’s courts recognise and enforce international arbitration awards? Please advise of any obstacles (legal or practical) to enforcement.

The Arbitration Act recognises and provides for enforcement of foreign arbitral awards in India; *vide* Part II thereof. The said Act gives effect to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958 (“New York Convention”) and the Convention on the Execution of Foreign Arbitral Awards, 1927 (“Geneva Convention”) with a specific reservation of principle of reciprocity under Sections 44(b) and 53(c) of the Act. Under the New York Convention, Indian courts may recognise and enforce foreign arbitral awards if the country is a signatory to the New York Convention and if the award is made in the territory of another contracting state which is a reciprocating territory. Section 57 of the Act enumerates the pre-requisites to enforce a foreign award under the Geneva Convention.

India is a signatory to the New York Convention, with reservations that there should be a valid agreement to arbitrate, and that such agreement must be evidenced in writing. Another reservation made by India is to the effect that the New York Convention would be applicable only to disputes and differences arising out of a legal “commercial” relationship between the parties, whether contractual or not. The Act mandates an award to be rendered in a country which is a signatory to the New York Convention, and which has been duly notified in the Official Gazette of India as being a signatory to the New York Convention. This can cause hardships as, whilst all important arbitration seats are recognised and notified, the Official Gazette has not notified all countries which are signatories to the Convention.

Section 48 of the Act provides for conditions which must be satisfied for enforcement of a foreign arbitral award in India under the New York Convention (these are all as per the New York Convention). The public policy ground is narrowly construed in India for enforcement of foreign awards.

The limitation period for enforcement of a foreign award would be the limitation period for execution of decrees, i.e., 12 years. (See Item 136, Schedule, Limitation Act, 1963 and *Imax Corporation v. E-City Entertainment (I) Pvt. Ltd. and Ors.*, (2017) 5 SCC 331.)

4.5 Where a contract provides for court proceedings in your jurisdiction, please outline the process adopted, any rights of appeal and a general assessment of how long proceedings are likely to take to reduce: (a) a decision by the court of first jurisdiction; and (b) a decision by the final court of appeal.

Proceedings before a court are initiated upon the receipt of a plaint by one of the parties. The court then serves summons to the opposite party to file their written statement. Issues are thereafter framed by the court and the case posted for trial. Evidence-in-chief is in the form of sworn affidavits and cross-examination is conducted in front of court-appointed commissioners. This is followed by the filing of documents and evidence by the claimant and the respondent, respectively. On conclusion of arguments on merits, the court reserves the matter to pronounce its judgment on a later date.

A claimant may request the court for a summary judgment in case of a certain debt and on lack of defence being available to the respondent wherein a judgment is sought without trial.

Parties may prefer an appeal to a High Court within a period of 90 days from the date of the impugned judgment of a lower court, or within a period of 30 days to any other court in India (Division II of the Schedule, Limitation Act, 1963). If parties are not satisfied with the judgment of a High Court, a Special Leave Petition (“SLP”) may be filed to the Supreme Court of India against any such judgment within a period of 90 days from the date of the impugned judgment (Order XXI, Rule 1, Supreme Court Rules, 2013). In case of refusal by a High Court to grant a certificate of appeal to prefer a SLP before the Supreme Court, an appeal to the Supreme Court may be preferred within 60 days of the impugned order of the High Court (Order XXI, Supreme Court Rules, 2013).

A decision from the court of first instance can be expected within a period of three to four years and within one to two years from the final court of appeal.

4.6 Where the contract provides for court proceedings in a foreign country, will the judgment of that foreign court be upheld and enforced in your jurisdiction? If the answer depends on the foreign country in question, are there any foreign countries in respect of which enforcement is more straightforward (whether as a result of international treaties or otherwise)?

The procedure for enforcement of foreign judgments in India differs on the basis of reciprocating and non-reciprocating territories. In case of “reciprocating territories”, judgments may be enforced directly as a decree and an execution decree may be obtained to this effect from an Indian court. Some of the notified reciprocating countries are the United Kingdom, Singapore and Hong Kong. On the other hand, judgments from “non-reciprocating” territories are not executed directly by a court of law. A fresh suit will have to be filed on the basis of the foreign judgment within three years of the judgment for its enforcement. This suit can be defeated only on six grounds set out in the Code of Civil Procedure as follows:

- (a) That the judgment has not been pronounced by a court of competent jurisdiction.
- (b) That it has not been given on merits, i.e. it is a default judgment.
- (c) That it is founded on an incorrect view of international law or a refusal to recognise Indian law (if applicable).
- (d) That the proceedings were opposed to natural justice.
- (e) That it has been obtained by fraud.
- (f) That it sustains a claim founded on breach of law in force in India.



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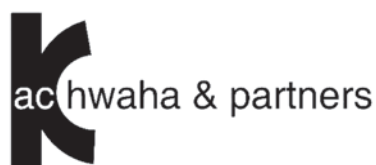
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1 Making Construction Projects

1.1 What are the standard types of construction contract in your jurisdiction? Do you have: (i) any contracts which place both design and construction obligations upon contractors; (ii) any forms of design-only contract; and/or (iii) any arrangement known as management contracting, with one main managing contractor and with the construction work done by a series of package contractors? (NB For ease of reference throughout the chapter, we refer to “construction contracts” as an abbreviation for construction and engineering contracts.)

Different contract types can be used depending on the peculiarities of the project. The employer may decide to appoint:

- a general contractor, who bears the risk of the entire construction including the selection, management, and coordination of all subcontractors and suppliers;
- a main contractor, who performs the main portion of a construction and coordinates with other contractors appointed by the employer;
- a few main contractors performing the main elements of the construction project (e.g. the building part, the mechanical part, the electrical part, the hydraulic part, etc.); or
- an individual contractor, according to a more traditional scheme characterised by a more fragmented risk allocation.

Contracts which place both design and construction obligations upon the contractor are used primarily in the forms of integrated design-build contracts or engineering, procurement and construction (EPC) contracts which are mainly used in the field of industrial plants.

1.2 How prevalent is collaborative contracting (e.g. alliance contracting and partnering) in your jurisdiction? To the extent applicable, what forms of collaborative contracts are commonly used?

Collaborative contracting in the sense of integrated project delivery or alliancing between all major parties of the project (including particularly the employer and the contractors) is not particularly developed in Italy.

The cooperation between contractors (especially for the participation in tenders) is achieved either (i) through joint venture agreements, with the establishment of a joint venture

corporate entity, or, more commonly, (ii) by concluding cooperation contracts (typically consortiums or *associazione temporanea di imprese*).

1.3 What industry standard forms of construction contract are most commonly used in your jurisdiction?

In Italy there are several standard forms of domestic construction contract that can be used, but there is not a prevailing one. Standard forms are published by different entities, such as chambers of commerce, professional associations (such as the Italian Association of Construction Companies) or advisors and consultants.

Public constructions are regulated by Legislative Decree No. 50/2016, and subsequent amendments (PCC). In public tender processes, the contract shall comply with the PCC requirements. Usually, the contract template is proposed by the public entity.

For international construction contracts, where the template is usually proposed by the financiers/employers, a number of international standard forms can be used, such as the International Federation of Consulting Engineers (FIDIC), Joint Contracts Tribunal (JCT), or Institute of Civil Engineers New Engineering Contract (NEC ICE) model forms, subject to extensive negotiation. However, when they need to be adapted to the Italian legislation, bespoke contracts are often preferred.

1.4 What (if any) legal requirements are there to create a legally binding contract (e.g. in common law jurisdictions, offer, acceptance, consideration and intention to create legal relations are usually required)? Are there any mandatory law requirements which need to be reflected in a construction contract (e.g. provision for adjudication or any need for the contract to be evidenced in writing)?

The requirements under Italian law to create a legally binding contract are listed under article 1325 Civil Code. These are: (i) the agreement of the parties; (ii) the cause of the contract; (iii) the subject matter; and, when expressly provided by the law, (iv) formal requirements. Construction contracts are often subject to special legal regimes addressing the tendering process and, in that context, formal requirements for the contract to be in writing may be set, in accordance with point (iv) above. Any such requirement may be imposed either as a matter of validity of the contract or as a matter of evidence.

1.5 In your jurisdiction please identify whether there is a concept of what is known as a “letter of intent”, in which an employer can give either a legally binding or non-legally binding indication of willingness either to enter into a contract later or to commit itself to meet certain costs to be incurred by the contractor whether or not a full contract is ever concluded.

Letters of intent are widely adopted when negotiating contracts. The extent to which such letters have legally binding effect can vary. Normally, letters of intent would make it express that they do not produce a legally binding contractual obligation. However, such documents may give rise to specific obligations (e.g. confidentiality) and may be crucial in determining the parties’ conduct throughout the negotiation, eventually exposing them to pre-contractual liability, this being a peculiar type of liability in tort set under article 1377 Civil Code.

1.6 Are there any statutory or standard types of insurance which it would be commonplace or compulsory to have in place when carrying out construction work? For example, is there employer’s liability insurance for contractors in respect of death and personal injury, or is there a requirement for the contractor to have contractors’ all-risk insurance?

The contractor must provide insurance covering its employees and workers against work accidents and occupational diseases with the National Institute for Insurance against Accidents at Work (INAIL). In addition, contractors are usually requested to have contractors’ all-risk insurance covering not only all risks connected with the works equipment but also civil liability for damages caused to third parties during the execution of the works. Additional insurances are normally requested depending on the peculiarities of the project.

1.7 Are there any statutory requirements in relation to construction contracts in terms of: (a) labour (i.e. the legal status of those working on site as employees or as self-employed sub-contractors); (b) tax (payment of income tax of employees); and/or (c) health and safety?

Labour

In Italy, various types of employment contract can be concluded in writing, either for a fixed or for an undetermined term. A number of obligations are imposed in order to avoid risks of irregular employment.

Tax

A case-by-case tax assessment is always needed, bearing in mind that the following are the main taxations: (i) corporate income tax (IRES); (ii) regional tax on productive activities (IRAP); and (iii) value-added tax (VAT).

Health and safety

Health and safety on construction sites is regulated by Legislative Decree No. 81/2008, which sets out the general principles and measures to be taken to guarantee the safety of workers employed on a project site and which must be complied with by the contractor (as well as by all its sub-contractors).

The employer is responsible for the implementation of health and safety measures on building sites and must, among others, issue the health and safety plan (*piano di sicurezza e coordinamento*) (PSC) and the *Documento Unico di Valutazione dei Rischi da Interferenza* containing the measures to be implemented to

eliminate or reduce risks deriving from the “interaction” in the workplace between activities performed by different contractors operating on-site.

The construction contract must clearly indicate the portion of the contract price that is paid by the employer to allow the contractor to comply with health and safety at work provisions.

1.8 Is the employer legally permitted to retain part of the purchase price for the works as a retention to be released either in whole or in part when: (a) the works are substantially complete; and/or (b) any agreed defects liability period is complete?

As the law does not provide for any such retention rights of the employer, the matter is regulated by a contract, which usually provides that the price is payable on a “milestones” basis. Thus, it is common for the employer to retain a certain amount (5–10% of each payment) to secure the performance of the contract. In general, the amounts retained are released in favour of the contractor only after completion of works and acceptance thereof (typically upon delivery and commissioning). The same may apply in respect of the expiry of the defects liability period, but in this case issuance of a specific bond is usually preferred.

1.9 Is it permissible/common for there to be performance bonds (provided by banks and others) to guarantee the contractor’s performance? Are there any restrictions on the nature of such bonds? Are there any grounds on which a call on such bonds may be restrained (e.g. by interim injunction); and, if so, how often is such relief generally granted in your jurisdiction? Would such bonds typically provide for payment on demand (without pre-condition) or only upon default of the contractor?

Employers commonly require contractors to provide bonds to secure the proper fulfilment of their obligations. The most common are: (i) advance payment bond, to secure the repayment of advance payment(s) effected to the contractor (if any); (ii) performance bond, to secure proper performance of the contractual obligations by the contractor; and (iii) warranty bond, to secure the warranty obligations by the contractor.

Bonds are usually requested to be first-demand bonds issued by banks (more rarely by insurances). A first-demand bond is an autonomous guarantee that can be called upon simple written demand. In case of an abusive call, the contractor is entitled to file an interim injunction. However, on-demand bonds are independent from the underlying contract, and courts or arbitral tribunals will look at the conditions provided in the bond *per se* and not in the underlying contract.

1.10 Is it permissible/common for there to be company guarantees provided to guarantee the performance of subsidiary companies? Are there any restrictions on the nature of such guarantees?

Downstream or cross-stream corporate guarantees, to be provided by parent or sister companies, are quite commonly requested by employers, especially in order to secure the obligations of contractors which (i) are SPVs or not large corporations, or (ii) form part of corporate groups structured in a plurality of companies.

Such guarantees are in principle allowed, to the extent that their issuance is in the corporate interest of the grantor. Therefore, the validity of such a guarantee is subject to the assessment of the benefit gained by the grantor (in return for granting the guarantee) directly, or at least in the form of “compensating advantage”.

1.11 Is it possible and/or usual for contractors to have retention of title rights in relation to goods and supplies used in the works? Is it permissible for contractors to claim that, until they have been paid, they retain title and the right to remove goods and materials supplied from the site?

In construction contracts, the transfer of property depends on the object of the construction:

- in the case of movable assets, if most of the materials are supplied by the contractor, the property of the entire *opus* passes upon the acceptance. Conversely, when most of the materials are supplied by the employer, the property of the *opus* is of the employer from the beginning; and
- in the case of immovable assets, if the soil is property of the employer and the materials are supplied by the contractor, the *opus* is property of the employer from the beginning, whilst if the soil is also property of the contractor, title passes upon acceptance.

Retention of title is permitted under Italian law and must be included by the parties in the contract.

The opportunity to insert retention of title clauses should always be evaluated on a case-by-case basis, also considering the effectiveness of their enforcement with respect to the object of the construction.

2 Supervising Construction Contracts

2.1 Is it common for construction contracts to be supervised on behalf of the employer by a third party (e.g. an engineer)? Does any such third party have a duty to act impartially between the contractor and the employer? If so, what is the nature of such duty (e.g. is it absolute or qualified)? What (if any) recourse does a party to a construction contract have in the event that the third party breaches such duty?

The supervision of construction contracts is usually performed by the works director. In public construction contracts, the employer must appoint the works director, who is responsible for the technical, accounting and administrative control of the performance of works, as well as for coordinating and supervising the activity of the works management office.

The works director appointed by the employer owes duties towards the employer and he is under no duty to act impartially between the employer and contractor, unless such duty is specifically included in his appointment. However, works directors are usually architects or engineers, and are thus subject to rules of professional conduct and practice issued by their professional associations.

2.2 Are employers free to provide in the contract that they will pay the contractor when they, the employer, have themselves been paid; i.e. can the employer include in the contract what is known as a “pay when paid” clause?

There is no prohibition under the law for any such agreement. The parties are therefore free to conclude agreements to this effect. This would imply establishing an express contractual link between the two contracts.

2.3 Are the parties free to agree in advance a fixed sum (known as liquidated damages) which will be paid by the contractor to the employer in the event of particular breaches, e.g. liquidated damages for late completion? If such arrangements are permitted, are there any restrictions on what can be agreed? E.g. does the sum to be paid have to be a genuine pre-estimate of loss, or can the contractor be bound to pay a sum which is wholly unrelated to the amount of financial loss likely to be suffered by the employer? Will the courts in your jurisdiction ever look to revise an agreed rate of liquidated damages; and, if so, in what circumstances?

According to article 1382 Civil Code, the parties are free to include in their contract a “*clausola penale*” under which, in case of particular contractual breaches (typically late completion/delivery or technical underperformance), liquidated damages shall be paid by the contractor to the employer.

Such clauses exempt the employer from proof of damage. Parties are free to agree that further damages may be claimed in addition to the liquidated damages.

Liquidated damages may be reduced *ex officio* by the judge, if the agreed sum is manifestly excessive or the main contractual obligation has been only partially unperformed.

3 Common Issues on Construction Contracts

3.1 Is the employer entitled to vary the works to be performed under the contract? Is there any limit on that right?

According to article 1661 Civil Code, the employer is entitled to order variations not exceeding one-sixth of the contract price and the contractor is entitled to compensation for the additional works.

If the variation, although not exceeding the above limit, materially alters the nature of the work or the extent of a specific activity, a new agreement on the variation is required.

This provision is normally waived or amended by the parties by extending the duty of the contractor to perform the variations and limiting its rights to additional compensation.

3.2 Can work be omitted from the contract? If it is omitted, can the employer carry out the omitted work himself or procure a third party to perform it?

The contractor is not allowed to omit works without the employer’s consent. Omission of works by a contractor constitutes breach of contract and determines the applicability of the relevant remedies. According to some scholars, the employer is entitled to reduce the contractual works by indemnifying the contractor for loss of profit and expenses already incurred.

In public construction, the right of the public employer to reduce the contractual works is specifically foreseen in article 106 PCC subject to the limitation indicated therein.

3.3 Are there terms which will/can be implied into a construction contract (e.g. a fitness for purpose obligation, or duty to act in good faith)?

In the execution of the contract, the parties must take into consideration not only what is foreseen in the contract itself, but also the consequences that are implied by law, usage and principles of equity (article 1374 Civil Code).

Rules of law apply to construction contracts although they are not specifically recalled into the contract itself, unless they are derogated by the parties.

Conversely, mandatory rules always apply. A clause excluding *a priori* all implied terms, such as an “entire agreement clause”, would be deemed invalid by courts insofar as it prevents the application of mandatory rules.

The principle of good faith in performance of the contract is foreseen in article 1375 Civil Code and applies, although not specifically recalled, in the contract.

The obligations of the contractor are qualified by scholars and case law as obligations of result.

3.4 If the contractor is delayed by two concurrent events, one the fault of the contractor and one the fault or risk of his employer, is the contractor entitled to: (a) an extension of time; and/or (b) the costs arising from that concurrent delay?

Performance of the works by the contractor within the time frame agreed upon between the parties is a key element of the construction contract; therefore, in case of delay, the contractor is only justified if he is able to prove that the delay was exclusively caused by an event beyond his control, i.e. by a *force majeure* event or by a fault of the employer. Whenever the delay is partially caused by the fault of the contractor, the contractor is not automatically entitled to benefit from any extension of time nor to receive reimbursement of costs.

3.5 Is there a time limit beyond which the parties to a construction contract may no longer bring claims against each other? How long is that period and when does time start to run?

Different time limits for the exercise of rights under construction contracts should be taken into consideration:

- for defects found after completion of the works, the employer will have to denounce such defects to the contractor within 60 days from their discovery and the legal proceedings will have to be commenced within two years from completion of the works;
- for decennial liability (see question 3.20), the defects have to be denounced within one year from their discovery and the rights of the claimant are subject to a one-year time limit running from the relevant notice; and
- any other rights of the parties are subject to the ordinary contractual time-bar of 10 years.

3.6 Which party usually bears the risk of unforeseen ground conditions under construction contracts in your jurisdiction?

If, during the execution of the project, geological, hydrological or similar difficulties arise which are not foreseen by the parties and make the performance of the contract considerably more onerous for the contractor, the contractor is entitled to receive an equitable indemnification in connection thereto according to article 1664 Civil Code. This provision is usually extensively negotiated depending on the peculiarities of the project and on who the entity that performs the ground/underground survey is (if any).

3.7 Which party usually bears the risk of a change in law affecting the completion of the works under construction contracts in your jurisdiction?

The parties normally take into consideration the legal provisions which are in force at the time when the contract is concluded. Furthermore, they normally introduce specific provisions about changes in law during the execution of the contract.

In the absence of such provisions, changes in law which are mandatory and occur after conclusion of the contract could be treated as events which give rise to necessary variations of the project, provided that the changes in law have an impact on the completion of the works under construction.

In such a case, whenever the parties cannot reach an agreement as to the apportionment of the relevant costs and timing of performance of the contract, the decision must be taken by the judge/arbitrator.

3.8 Which party usually owns the intellectual property in relation to the design and operation of the property?

Intellectual property related to the design is owned by the relevant designer, who usually provides an irrevocable, royalty-free, non-exclusive licence to the employer to use such designs for the purposes indicated in the relevant contract. The ownership of the design documentation can be transferred to the employer, subject to the author always maintaining his moral right to be recognised as such.

3.9 Is the contractor ever entitled to suspend works?

Article 1460 Civil Code embodies the general principle of Roman law according to which, in synallagmatic contracts, *inadimplenti non est adimplendum*; i.e., each party may suspend performance of its obligations in case the other party is in breach of its own corresponding obligations.

In the absence of specific contractual stipulations, this rule is quite often invoked by contractors in order not to deliver the promised works to the employer in case of failure by the employer to pay the relevant price instalments.

3.10 Are there any grounds which automatically or usually entitle a party to terminate the contract? Are there any legal requirements as to how the terminating party's grounds for termination must be set out (e.g. in a termination notice)?

In general, a party may invoke termination of contract for a material default of the other party after having served prior notice, thereby affording the possibility to remedy.

However, the parties can provide for the right of automatic termination of the contract for the events stipulated therein. Typically, this would be the consequence in the case of excessive delay or underperformance of works over agreed thresholds.

Similarly, in the absence of contractual provisions, article 1660 Civil Code grants to the contractor the right of automatic termination in case of necessary variations exceeding one-sixth of the agreed price.

3.11 Do construction contracts in your jurisdiction commonly provide that the employer can terminate at any time and for any reason? If so, would an employer exercising that right need to pay the contractor's profit on the part of the works that remains unperformed as at termination?

The right of the employer to terminate a construction contract at any time and for any reason, even if the execution of works has

already been commenced, is provided in article 1671 Civil Code. In this case, the employer shall compensate the contractor for the incurred costs, the works already performed and loss of profit.

3.12 Is the concept of *force majeure* or frustration known in your jurisdiction? What remedy does this give the affected party? Is it usual/possible to argue successfully that a contract which has become uneconomic is grounds for a claim for *force majeure*?

A *force majeure* event which renders an obligation impossible to be performed relieves the affected party from liability, and it causes the extinguishment of the same obligation and the termination of the contract.

In case of a contract having become uneconomic for a party, such party would not be entitled to invoke *force majeure*, but if extraordinary and unforeseeable events have rendered the performance excessively onerous, it would in any case be entitled to demand termination of the contract for “*ecessiva onerosità sopravvenuta*” unless the other party proposes to adapt the conditions of the contract.

3.13 Are parties, who are not parties to the contract, entitled to claim the benefit of any contractual right which is made for their benefit? E.g. is the second or subsequent owner of a building able to claim against the contractor pursuant to the original construction contracts in relation to defects in the building?

Regarding construction of buildings, title to sue the contractor under article 1669 Civil Code, i.e. to claim damages arising from collapse, risk of collapse or major defects (see question 3.20), pertains not only to the employer but also to subsequent purchasers of the building who acquired property from the same employer. However, such right is not based in contract but in tort.

3.14 On construction and engineering projects in your jurisdiction, how common is the use of direct agreements or collateral warranties (i.e. agreements between the contractor and parties other than the employer with an interest in the project, e.g. funders, other stakeholders, and forward purchasers)?

“Direct agreements” between the contractor and the employer’s financiers are used in project finance: usually certain contractual warranties or undertakings of the contractor *vis-à-vis* the employer are assigned by the employer to its financiers (to secure the lenders’ interests). To the same purpose, performance bonds or other collateral warranties (e.g. parent company guarantees) issued in favour of the employer are often similarly assigned.

In certain projects (typically when the employer’s business is the resale of the object of the construction), certain contractual warranties of the employer may be assigned to final customers.

3.15 Can one party (P1) to a construction contract, who owes money to the other (P2), set off against the sums due to P2 the sums P2 owes to P1? Are there any limits on the rights of set-off?

Set-off is allowed when the opposite credits are equally liquid, undisputed and payable. The most frequent situation of set-off occurs between the contractor’s credits for outstanding contract

price and the employer’s credit for liquidated damages. In such a case, however, it is quite frequent that set-off can only operate after any dispute about the entity of liquidated damages has been resolved by the judge, as a result of which the set-off will operate not by effect of law but as a result of the judgment (so-called judicial set-off).

3.16 Do parties to construction contracts owe a duty of care to each other either in contract or under any other legal doctrine? If the duty of care is extra-contractual, can such duty exist concurrently with any contractual obligations and liabilities?

It is a general principle embodied under article 1375 Civil Code that the parties shall give performance to the contract according to good faith. Claims in tort are instead based on the *neminem laedere* principle. Generally speaking, liabilities in contract are different in nature from liabilities in tort. However, this does not exclude that certain facts may give rise to both liabilities, and the Supreme Court has held that under certain circumstances the two legal actions may cumulate.

3.17 Where the terms of a construction contract are ambiguous, are there rules which will settle how that ambiguity is interpreted?

When interpreting a contract, courts will be aimed at ascertaining the common intention of the parties. The literal interpretation will be the dominant criterion. However, in case of ambiguity, the following further criteria will be adopted: (a) logical and contextual interpretation aiming at construing provisions within the whole contractual context; (b) functional interpretation, which guides the judge in identifying the real purpose of the parties’ intention; and (c) interpretation in good faith, and contractual solidarity which should avoid speculative interpretation theories.

3.18 Are there any terms which, if included in a construction contract, would be unenforceable?

Certain mandatory provisions of law can render unenforceable a contractual term which is contrary to such provisions. Typically, article 1229 Civil Code provides that any clause that excludes or limits the liability of the debtor in case of wilful misconduct (*dolo*) or gross negligence (*colpa grave*) is null and void. Furthermore, under article 1341 Civil Code, when contracts are executed under the general terms and conditions of one party, a number of contractual provisions shall result unenforceable unless specifically approved in writing by the other party. This includes limitations of liability, jurisdiction and arbitration clauses, automatic renewals, forfeitures of rights and waivers.

3.19 Where the construction contract involves an element of design and/or the contract is one for design only, are the designer’s obligations absolute or are there limits on the extent of his liability? In particular, does the designer have to give an absolute guarantee in respect of his work?

In the case that the employer appoints the designer, the designer is subject to contractual liability. The designer shall perform his obligations with diligence, to be assessed with reference to the nature of the performed activity in accordance with article

1176 Civil Code. However, if the design object of the professional appointment implies the solution of technical problems of particular difficulty, the designer is liable only in case of gross negligence or wilful misconduct pursuant to article 2236 Civil Code.

The Supreme Court clarified that the realisation of a technical project by an engineer constitutes an obligation of result and not of means.

3.20 Does the concept of decennial liability apply in your jurisdiction? If so, what is the nature of such liability and what is the scope of its application?

With reference to the construction of buildings or other real estate, article 1669 Civil Code provides for the statutory 10-year liability of the contractor in case of collapse, risks of collapse or other major defects deriving from defects of the soil or defective construction.

This special form of liability, which can neither be derogated nor modified by the contracting parties, is a liability in tort which creates a sort of presumption of fault on the part of the contractor (who therefore has the burden of proving its lack of liability).

4 Dispute Resolution

4.1 How are construction disputes generally resolved?

In Italy there are no specialised courts only dealing with the matter of construction.

A distinction should be drawn between construction disputes which concern technical matters and disputes which concern the legal interpretation of the terms and conditions of construction contracts.

Technical disputes may be referred to the decision of a third party – normally a technical company of specialised surveyors – whose decision will be final and binding upon the parties; however, legal disputes are normally referred to court or arbitration.

4.2 Do you have adjudication processes in your jurisdiction (whether statutory or otherwise) or any other forms of interim dispute resolution (e.g. a dispute review board)? If so, please describe the general procedures.

The Italian legal system has adopted forms of interim and alternative dispute resolution quite recently.

The procedure of “mediation” has been regulated in Italy by Act No. 28/2010 and is compulsory in certain areas of law, but not in the matter of construction contracts. However, mediation clauses are increasingly used in construction contracts which are concluded within the Italian jurisdiction, and the success of mediation is mainly related to the quality and skill of the mediators.

An ancient and well-established procedure, which is typical of Italian law, is the kind of arbitration named “*arbitrato irrituale*” (as opposed to the ordinary arbitration proceedings which are named “*arbitrato rituale*”) according to which the arbitrators, rather than being vested with a jurisdictional power, are given authority by the parties to issue an award which contains a settlement of the dispute. In such a case, the remedies against the award are quite limited.

4.3 Do the construction contracts in your jurisdiction commonly have arbitration clauses? If so, please explain how, in general terms, arbitration works in your jurisdiction.

Arbitration can either be institutional or non-institutional. In case of institutional arbitration, the rules of the relevant institution hosting the arbitration apply, thereby prevailing upon the rules of the Code of Civil Procedure. The most important arbitration institutions in Italy are the Milan Chamber of Arbitration (CAM) and the Italian Association for Arbitration (AIA).

4.4 Where the contract provides for international arbitration, do your jurisdiction’s courts recognise and enforce international arbitration awards? Please advise of any obstacles (legal or practical) to enforcement.

Recognition and enforcement of international arbitration awards in Italy are regulated by the 1958 New York Convention on arbitration, which was adopted by Act No. 112/1974. Therefore, foreign international arbitration awards are easily recognised and enforced in Italy provided that an agreement in writing, to refer the dispute to arbitration, was validly concluded between the parties to the contract.

4.5 Where a contract provides for court proceedings in your jurisdiction, please outline the process adopted, any rights of appeal and a general assessment of how long proceedings are likely to take to reduce: (a) a decision by the court of first jurisdiction; and (b) a decision by the final court of appeal.

Court proceedings at first instance are held in Italy by 139 local tribunals, which have a wide jurisdiction on any civil and commercial matters, divided geographically by districts. The average duration of proceedings at first instance is three to four years. Appeal is allowed without a need for the party to obtain any specific leave, and the Courts of Appeal have full power to review the case on its merits, although new evidence is not allowed. There are 26 Courts of Appeal and the average duration of an appeal case is again three to four years. Against the appeal decisions it is still possible to file an application to the Supreme Court in Rome, but only for errors of law and not for a further review of the facts or the merits of the case.

4.6 Where the contract provides for court proceedings in a foreign country, will the judgment of that foreign court be upheld and enforced in your jurisdiction? If the answer depends on the foreign country in question, are there any foreign countries in respect of which enforcement is more straightforward (whether as a result of international treaties or otherwise)?

The general rule is that foreign judgments are recognised and enforced in Italy through a simple procedure, without any review of the merits of the case, providing that the basic rules in the matter of right of defence were observed by the foreign judge. If the judgment to be recognised and enforced in Italy has been issued in a country which is a member of the European Union, the enforcement of such foreign EU judgment in Italy can take place automatically, by simply obtaining “*exequatur*” and without the need to undergo any procedure, in view of the principle of freedom of circulation of judgments within EU territory.



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He has comprehensive litigation experience and acts as counsel in complex national and international construction and procurement disputes, both in court and in arbitration.

Luca also assists and advises clients in all phases of a project, including preparation of the tendering, participation in negotiations, follow-up and handling of matters and claims during the project execution and the warranty period.

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Based in Genoa and Milan, Dardani Studio Legale is an international boutique law firm that gathers a team of advocates specialised in maritime, international trade, and construction law dealing with a broad range of shipping, commercial, corporate, and construction matters.

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Dardani Studio Legale is regularly involved not only in the contract drafting and negotiation phase, but also in the management of project claims and in the resolution of disputes.

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Hajime Kanagawa

1 Making Construction Projects

1.1 What are the standard types of construction contract in your jurisdiction? Do you have: (i) any contracts which place both design and construction obligations upon contractors; (ii) any forms of design-only contract; and/or (iii) any arrangement known as management contracting, with one main managing contractor and with the construction work done by a series of package contractors? (NB For ease of reference throughout the chapter, we refer to “construction contracts” as an abbreviation for construction and engineering contracts.)

Japan has several types of contracts that have been created by industry associations and are widely used as templates. The most commonly used templates are: (a) the Central Council for Construction Business (*chuuou kensetsu gyou shingi kai*) model contracts (the “CCMC”), used for (i) public construction contracts, (ii) private large-scale construction contracts, (iii) private small-scale construction contracts, and (iv) sub-contracting contracts; and (b) the Private Associations of Architects and Contractors (*minkan (nanakai) rengou kyoutei koyji ukeoi keiyaku yakkan iinnkai*) model form (the “PAMF”). The PAMF is based on the CCMC and is the most frequently used model form for private construction projects as a matter of practice.

For design and supervision services, there is a model agreement drafted by the Private Associations of Architects (*shikai rengou kyoutei kenbikusekkei kanritou gyoumu itakukeiyaku yakkan chousa kennkyunkai*) (the “PAMDSA”). Further, there are design and construction agreements drafted by the Japan Federation of Construction Contractors (*nihon kensetsugyou rengonkai*), and model domestic plant construction contracts published by the Engineering Advancement Association of Japan (*enjiniaringu kyounkai*).

For the arrangement known as “management contracting”, there is no standard form. Note that an arrangement with one main contractor directly entering into a construction contract with an employer and then entering into sub-construction contracts with sub-contractors for the same construction project is generally possible, but such arrangement should not fall within “blanket sub-contracting” (*ikkatsu shitankeoi*), which is prohibited under the Construction Business Act (Act No. 199 of 1949, as amended, the “CBA”).

1.2 How prevalent is collaborative contracting (e.g. alliance contracting and partnering) in your jurisdiction? To the extent applicable, what forms of collaborative contracts are commonly used?

In Japan, there is a partnering system similar to collaborative

contracting which is called “construction joint venture” (*kensetsu kyoudou jig'youtai*) and is commonly used among small and mid-sized construction business operators. There are the following three types of construction joint venture:

- (1) **Special Construction Joint Venture**
This is a construction joint venture established on a per project basis in the case of a large-scale or technically difficult project for the purpose of securing the stable execution of the construction project.
- (2) **Ordinary Construction Joint Venture**
This is a construction joint venture established by small and mid-sized construction business operators for the purpose of strengthening operating and project execution potential through secure and continuous business relations. This type of joint venture is formed at the time of application for a qualified contracting body in a tendering process.
- (3) **Regional Maintenance Type Construction Joint Venture**
This type of construction joint venture was added in 2011 to encourage local construction business operators (mainly small and mid-sized) who are familiar with the region to partner up with others to conduct maintenance work for infrastructure within the region.

The joint venture agreement forms for each of the above three types of construction joint ventures made by the Ministry of Land, Infrastructure, Transport and Tourism are commonly used.

1.3 What industry standard forms of construction contract are most commonly used in your jurisdiction?

The CCMC and the PAMF are the most commonly used industry standard forms of construction contract in Japan.

1.4 What (if any) legal requirements are there to create a legally binding contract (e.g. in common law jurisdictions, offer, acceptance, consideration and intention to create legal relations are usually required)? Are there any mandatory law requirements which need to be reflected in a construction contract (e.g. provision for adjudication or any need for the contract to be evidenced in writing)?

Under the Japanese Civil Code (Act No. 89 of 1887, as amended, the “Civil Code”), in principle, contracts become valid and binding once parties’ intentions match each other. No other actions are required except for certain types of agreement that are required to be in writing. However, under the CBA, construction contracts must be executed by the parties in writing and must provide for (i) scope of work, (ii) price for the work, (iii) commencement and completion date, (iv) timing and manner of advance payment and piece-work payment (if applicable), (v)

variation, (vi) *force majeure*, (vii) price adjustment, (viii) damages to third parties, (ix) use of materials and equipment, (x) inspection and delivery, (xi) terms of payment, (xii) defect liability and insurance, (xiii) delay and damages, and (xiv) dispute resolution.

1.5 In your jurisdiction please identify whether there is a concept of what is known as a “letter of intent”, in which an employer can give either a legally binding or non-legally binding indication of willingness either to enter into a contract later or to commit itself to meet certain costs to be incurred by the contractor whether or not a full contract is ever concluded.

As a matter of practice, letters of intent (“LOIs”) are rarely used in Japan in connection with the execution of construction contracts. However, LOIs are commonly used in other contexts such as M&A, so it is not an unfamiliar concept. Whether the LOI is binding or non-binding may be specified in the agreement.

1.6 Are there any statutory or standard types of insurance which it would be commonplace or compulsory to have in place when carrying out construction work? For example, is there employer’s liability insurance for contractors in respect of death and personal injury, or is there a requirement for the contractor to have contractors’ all-risk insurance?

By law, during the construction period, the parties to construction contracts are only required to purchase (i) insurance that covers contractors’ employees, and (ii) insurance for defects in newly constructed housing if the contractor has not deposited funds to cover such defects. Additionally, under construction contracts, contractors are generally required to have certain types of insurance. For example, under the CCMC and the PAMF, contractors must have fire insurance or construction insurance and any other insurance stipulated under the design documents. This insurance must cover the completed portion of construction works, building materials, and building facility equipment brought onto the construction site.

1.7 Are there any statutory requirements in relation to construction contracts in terms of: (a) labour (i.e. the legal status of those working on site as employees or as self-employed sub-contractors); (b) tax (payment of income tax of employees); and/or (c) health and safety?

Under the CBA, construction contracts must include the items enumerated under the answer to question 1.4 above. However, there are no statutory requirements for construction contracts in terms of (a) labour contracts that contractors enter into with employees who engage in construction work at the construction site, (b) payment of income tax of employees (though contractors owe an obligation to pay withholding tax in connection with salary payments to employees), or (c) safety and hygiene.

1.8 Is the employer legally permitted to retain part of the purchase price for the works as a retention to be released either in whole or in part when: (a) the works are substantially complete; and/or (b) any agreed defects liability period is complete?

Under the Civil Code, in principle, an employer must pay the construction fee to the contractor in exchange for delivery of completed works after the full completion of the works, unless otherwise agreed, provided, however, that: (i) in the event that

the contractor cannot complete the work due to reasons attributable to the employer, the employer shall pay the construction fee in full; and (ii) in the event that (a) the contractor cannot complete the work due to reasons not attributable to the employer, or (b) the construction contract is terminated before the completion of the works, the employer shall pay part of the construction fee in proportion to the benefits the employer obtains upon the delivery of the completed portion of the works. Therefore, depending on the reason for the contractor’s failure to deliver fully completed work and the level of benefits obtained by the employer from partially completed work, the employer has the right to refuse part of the payment of the construction fee. Furthermore, the CBA imposes special obligations for payment on the main contractor in a sub-contractor contract. For example, a main contractor engaging a sub-contractor of a certain size generally has the obligation to pay the construction fee to its sub-contractor within 50 days from such sub-contractor’s offer to deliver the construction work.

1.9 Is it permissible/common for there to be performance bonds (provided by banks and others) to guarantee the contractor’s performance? Are there any restrictions on the nature of such bonds? Are there any grounds on which a call on such bonds may be restrained (e.g. by interim injunction); and, if so, how often is such relief generally granted in your jurisdiction? Would such bonds typically provide for payment on demand (without pre-condition) or only upon default of the contractor?

Performance bonds are often used in public construction projects that require deposits or other collateral to ensure the performance of the contractor under the Accounting Act (Act No. 35 of 1947, as amended) or Local Government Act (Act No. 67 of 1947, as amended), but such arrangements are uncommon for private construction projects, other than overseas projects. Performance bonds can take various forms to the extent permitted under the applicable laws, such as deposits, guarantees or insurance.

While a provisional injunction (*karishobun*) may theoretically be a possible tool to restrict a call on the bonds based upon, for example, non-satisfaction of the conditions for a call, generally, in order to obtain a provisional injunction, the contractor must demonstrate to the court that it has rights to be protected and there is a necessity for the interim relief, based on *prima facie* proof.

Performance bonds typically provide for payment only upon default and other related matters of the contractor.

1.10 Is it permissible/common for there to be company guarantees provided to guarantee the performance of subsidiary companies? Are there any restrictions on the nature of such guarantees?

Company guarantees are common in Japan and are often used in cases where the company is requested to guarantee the performance of subsidiary companies. There are no laws or regulations that prohibit or restrict the nature of such guarantees.

1.11 Is it possible and/or usual for contractors to have retention of title rights in relation to goods and supplies used in the works? Is it permissible for contractors to claim that, until they have been paid, they retain title and the right to remove goods and materials supplied from the site?

Under the Civil Code, ownership of construction works largely depends on who has supplied the construction materials.

Generally, works that have been built with materials supplied by the contractor belong to the contractor until it hands over such construction work to the employer, unless otherwise agreed under the construction agreements. Similarly, works built using materials supplied by the employer generally belong to the employer from the beginning of construction.

If an employer supplies the materials, a contractor may use a statutory lien to retain the completed construction work until the construction fee has been fully paid.

2 Supervising Construction Contracts

2.1 Is it common for construction contracts to be supervised on behalf of the employer by a third party (e.g. an engineer)? Does any such third party have a duty to act impartially between the contractor and the employer? If so, what is the nature of such duty (e.g. is it absolute or qualified)? What (if any) recourse does a party to a construction contract have in the event that the third party breaches such duty?

In some construction contracts (especially those involving building construction satisfying a certain statutory threshold), the employer hires a licensed architect (or an architecture office having a licensed architect) as a supervisor to supervise construction work. While a supervisor hired by an employer is considered to have a duty of care to the employer, as a licensed architect, the architect in charge of such supervisory work also owes a statutory obligation to supervise construction work, among other things, to ensure that the actual work conforms with the design documents and, if not, require the contractor to fix such discrepancy.

2.2 Are employers free to provide in the contract that they will pay the contractor when they, the employer, have themselves been paid; i.e. can the employer include in the contract what is known as a “pay when paid” clause?

Theoretically, such a provision could be included if both parties agree, provided that, under the CBA, the main contractor in a sub-contractor contract pays the construction fee to the sub-contractor as early as possible, but within one month from the main contractor's receipt of its construction fee. Furthermore, a main contractor engaging certain small-sized sub-contractors generally has the obligation to pay the construction fee to its sub-contractor within 50 days of such sub-contractor's offer to deliver the construction work, regardless of whether such main contractor has been paid by the employer.

2.3 Are the parties free to agree in advance a fixed sum (known as liquidated damages) which will be paid by the contractor to the employer in the event of particular breaches, e.g. liquidated damages for late completion? If such arrangements are permitted, are there any restrictions on what can be agreed? E.g. does the sum to be paid have to be a genuine pre-estimate of loss, or can the contractor be bound to pay a sum which is wholly unrelated to the amount of financial loss likely to be suffered by the employer? Will the courts in your jurisdiction ever look to revise an agreed rate of liquidated damages; and, if so, in what circumstances?

The parties may agree to liquidated damages which need not necessarily reflect the actual or reasonably estimated amount of damage. However, although the basic rule is that the court may not reduce the amount of compensation for any damage incurred

due to breach of contract once such amount has been agreed under the contract (under Article 420 of the Civil Code), there is an exception if the amount is unusually excessive or otherwise violates public policy (*koujyo ryousokun*), so there is some limit to the amounts that will actually be recognised by the courts.

3 Common Issues on Construction Contracts

3.1 Is the employer entitled to vary the works to be performed under the contract? Is there any limit on that right?

Under the Civil Code, when the scope of construction work agreed under the construction contracts needs to be changed, both parties thereto must agree to such change, unless otherwise agreed in the construction contracts. Under Paragraph 1 of Article 28 of the PAMF, the employer has the right to add or change the scope of construction work without the consent of the contractor, but the employer must accept the change in the construction fee and compensate for any damages incurred by the contractor due to such addition or change in scope. In contrast, under Article 28 of the PAMF, the contractor must obtain the employer's consent to change the scope of construction work and any change in the construction fee inevitably resulting from such change of scope.

3.2 Can work be omitted from the contract? If it is omitted, can the employer carry out the omitted work himself or procure a third party to perform it?

If omission of work from the contract can be regarded as a change in the scope of work, it may be subject to the process discussed in the previous question. Also, any process that has been excluded from the scope of work may be completed by the employer or any third parties other than the contractor, because the law and the model construction contracts are basically silent on this issue.

3.3 Are there terms which will/can be implied into a construction contract (e.g. a fitness for purpose obligation, or duty to act in good faith)?

The provisions in the contracts should be reasonably interpreted based on the purposes of the parties, the circumstances of entering into the contracts, customs, and transaction conventions. Therefore, depending on the situation, implied terms such as fitness for purpose or duty to act in good faith may be taken into account when interpreting contractual provisions.

3.4 If the contractor is delayed by two concurrent events, one the fault of the contractor and one the fault or risk of his employer, is the contractor entitled to: (a) an extension of time; and/or (b) the costs arising from that concurrent delay?

Under the Civil Code, in general, the contractor is liable for any delay in construction and required to compensate for damages incurred by the employer due to any delay attributable to the contractor. However, for any delay attributable to the employer, the contractor is not liable for any delay in construction and, depending on the situation, may have a claim against the employer for reimbursement of costs or expenses that have increased due to the delay.

Under Article 20 of the PAMF, it is clearly provided that the contractor may claim (i) an extension of the construction period, and (ii) reimbursement for costs and expenses that have increased due to a delay attributable to the employer.

If a delay is caused by events that are attributable to both the contractor and the employer, it is likely that the amount of compensation for the damage that each party can claim from the other will be adjusted based on the relative fault of the parties.

3.5 Is there a time limit beyond which the parties to a construction contract may no longer bring claims against each other? How long is that period and when does time start to run?

Under the new Civil Code which became effective as from April 1, 2020, other than the items subject to a specific statute of limitations period (*jyoseki kikan*) (i.e., claims for defect liability as discussed below), the general statute of limitations period (*shoumetsu jikou*) for claims under construction contracts is (i) 10 years from the time the claimant becomes free from any legal obstacles to exercise such claim (e.g., completion of the design or construction work), or (ii) five years from the time the claimant knows it has the legal right to make such claim, whichever is earlier. On the other hand, the specific statute of limitations period (*jyoseki kikan*) for employers' claims against contractors for defect liability (i.e., liability due to non-conformity of the subject matter of the work with the terms of the contract in respect of kind and quality) is one year from the time the claimant knows it can make such claim.

Please note, however, that the old rule is still applicable to claims to be accrued under construction contracts executed before April 1, 2020 and, therefore, other than the items subject to a specific statute of limitations period (*jyoseki kikan*) (i.e., claims for defect liability as discussed below), the general statute of limitations period (*shoumetsu jikou*) for claims under construction contracts is: (i) five years, if either party is a corporation or any other legal entity; or (ii) 10 years, if both parties are individuals. This period generally starts from the time when the claimant becomes free from any legal obstacles to exercise such claim. The specific statute of limitations period (*jyoseki kikan*) for employers' claims against contractors for defect liability is: (i) 10 years in the case of buildings or any other construction made of stone, soil, bricks, concrete, metals, or any other similar materials; and (ii) five years in the case of buildings or any other construction made of materials other than those mentioned in (i) above; and starts from the delivery or completion of the construction work.

3.6 Which party usually bears the risk of unforeseen ground conditions under construction contracts in your jurisdiction?

Excluding the exceptional case where the "fair and equitable" principle is applied, and unless otherwise agreed under the construction contract, in the case of a fixed-amount contract, the employer usually bears the risk of unforeseen ground conditions. On the other hand, under Article 16 of the PAMF, the parties to construction contracts may negotiate and discuss changes in construction fees based upon unpredictable events detrimental to the construction work caused by unforeseen ground conditions.

3.7 Which party usually bears the risk of a change in law affecting the completion of the works under construction contracts in your jurisdiction?

Excluding the exceptional case where the fair and equitable principle is applied, and unless otherwise agreed under the

construction contract, in case of fixed-amount contracts, the employer generally bears the risk of changes in laws. In practice, under Article 29 of the PAMF, the contractor is allowed to change the construction fee if the amount becomes clearly inappropriate as a result of changes in applicable laws, which may enable the contractor to transfer the risk of a change in law to the employer to some extent.

3.8 Which party usually owns the intellectual property in relation to the design and operation of the property?

The intellectual property in relation to the design and operation of the property is usually owned by the creator of such intellectual property, unless otherwise contractually agreed. The intellectual property rights of design documents and buildings (insofar as they have a creative design) are copyright and moral rights. The intellectual property rights that may occur in relation to construction materials, building equipment, and methods of construction are patent rights, utility model rights, design rights, and trademark rights, which are usually owned by the inventor.

3.9 Is the contractor ever entitled to suspend works?

Under the Civil Code, there is no provision specifically permitting contractor's suspension of the work. However, as a matter of practice, such default rule under the Civil Code is often amended and actually, under Article 32 of the PAMF, a contractor may suspend work in the following situations:

- (1) advance payment or partial payment by the employer is overdue;
- (2) the employer, unreasonably, rejects cooperation with the contractor for discussions necessary for the variation of the work, construction schedule, and construction price;
- (3) the employer cannot prepare the construction site for the contractor to use, or the contractor cannot perform due to *force majeure*, etc.; or
- (4) the construction was extraordinarily delayed due to reasons attributable to the employer other than the above.

Upon the occurrence of any of these conditions, the contractor must send a written notice demanding cure of such situation within a reasonable period and can only suspend work if such situation is not cured by the employer within such reasonable period.

Additionally under Article 32 of the PAMF, a contractor may suspend work by sending written notice to the employer if it is recognised that the employer may lack credibility to pay the construction price due to reasons such as the employer suspending its payments.

Similarly, in case law, a lower court approved suspension of work on the grounds that the contractor feared non-payment of the construction cost by the employer (Tokyo Dist. Ct. Judgment of 29 August 1997, 1634 Hanrei Jiho 99).

3.10 Are there any grounds which automatically or usually entitle a party to terminate the contract? Are there any legal requirements as to how the terminating party's grounds for termination must be set out (e.g. in a termination notice)?

Under the Civil Code which became effective as from April 1, 2020, a party may terminate a construction contract in the following situations unless the non-performance of the counter party is due to reasons attributable to the terminating party:

- (i) if the terminating party demands the counter party to perform its obligations under the construction contract by

specifying a reasonable deadline and the counter party fails to perform such obligations by such deadline, as long as such non-performance is not immaterial;

- (ii) if the counter party's performance of the whole of the obligation is impossible;
- (iii) if the counter party clearly manifests the intention to refuse to perform the obligation in whole;
- (iv) if the counter party's performance of a part of the obligation is impossible (or if the counter party clearly manifests the intention to refuse to perform such part of the obligation) and the purpose of the contract cannot be achieved with only the performance of the remaining part of the obligation;
- (v) if, due to the nature of the construction contract or a manifestation of intention by the parties, the purpose of the construction contract cannot be achieved unless the obligation is performed at a specific time on a specific date or within a certain period of time, and the counter party fails to perform its obligation at that time or before that period expires; or
- (vi) if the counter party does not perform its obligation and it is obvious that the counter party is unlikely to perform its obligation to the extent necessary to achieve the purpose of the construction contract even if the terminating party makes the demand by specifying a certain deadline.

Under the Civil Code, the parties may terminate the contract on the above grounds even if this is not expressly set out in the construction contract, unless the parties have specifically relinquished such rights in the contract.

According to Paragraph 2 of Article 31 of the PAMF, the employer may terminate a construction contract by sending written notice to the contractor for any of the following reasons:

- (1) the contractor fails to start construction work after the starting date without justifiable reason;
- (2) the construction work is significantly behind schedule without justifiable reason and it is unlikely that the contractor would complete the construction work within the construction period or within a reasonable period after the construction period;
- (3) the contractor breaches Article 5 (prohibition of blanket sub-contracting and blanket delegation) or Paragraph 1 of Article 17 (repair due to construction work not following the design document) of the PAMF;
- (4) the contractor breaches the contract (in a way other than in (1) to (3) above) and the purpose of the contract cannot be accomplished due to such breach;
- (5) the construction licence of the contractor is cancelled or becomes invalid;
- (6) it is recognised that the contractor is in danger of becoming unable to continue the construction work due to reasons such as manifesting suspension of its payment on a general and continuous basis (e.g., any note or cheque issued by the contractor is dishonoured);
- (7) the contractor proposes termination of the agreement without any reason that falls under Paragraph 4 of Article 32 ((1) to (3) of the list below) of the PAMF; or
- (8) the contractor or its members have relationships with organised crime groups, etc.

Furthermore, according to Paragraph 1 of Article 31 of the PAMF, the employer may terminate the construction contract as necessary by sending written notice to the contractor (the employer will need to compensate the contractor for any damages arising due to the termination).

According to Paragraphs 4 and 5 of Article 32 of the PAMF, the contractor may terminate the construction contract by sending written notice to the employer in the event that any of the following occur:

- (1) the period of delay or suspension (pursuant to Paragraph 1 of Article 31 or Paragraph 1 of Article 32 of the PAMF) lasts for (a) a quarter or more of the construction period, or (b) two months or more;
- (2) the construction cost is decreased by two-thirds or more because the employer significantly decreased the construction work;
- (3) the employer breached the contract and the purpose of the contract cannot be accomplished due to such breach;
- (4) the employer or its members have relationships with organised crime groups, etc.; or
- (5) it is recognised that the employer lacks credibility to pay the construction price due to reasons such as manifesting suspension of its payment on a general and continuous basis (e.g., any note or cheque issued by the employer is dishonoured).

3.11 Do construction contracts in your jurisdiction commonly provide that the employer can terminate at any time and for any reason? If so, would an employer exercising that right need to pay the contractor's profit on the part of the works that remains unperformed as at termination?

Under the Civil Code, the parties may terminate the contract on the grounds enumerated in question 3.10 above even if this is not expressly set out in the construction contract, unless the parties have specifically relinquished such rights in the contract.

3.12 Is the concept of *force majeure* or frustration known in your jurisdiction? What remedy does this give the affected party? Is it usual/possible to argue successfully that a contract which has become uneconomic is grounds for a claim for *force majeure*?

While the exact scope of *force majeure* is not specifically defined under the Civil Code, we have a concept of *force majeure* and, therefore, if a party defaults due to *force majeure* or any other reason not attributable to the parties, such party may be released from the performance of such obligation in default (except for a default of monetary obligations) depending on the situation.

Furthermore, there is a similar (while not identical) concept of frustration. For example, some court cases have permitted that: (i) a contract will terminate if an obligation becomes impossible to perform due to reasons that are not attributable to the parties; and (ii) the parties may revise or terminate a contract if (a) a major change of circumstances (objective circumstances) occurs that was unforeseeable at the time of the signing date, (b) such major change cannot be attributable to the parties, and (c) forcing a party to perform its obligations under the original contract is markedly unfair and against the "principle of good faith" (*shingi-soku*) (the "principle of circumstantial change" (*jijou benkou no gensoku*)). However, it is very unlikely that the "principle of circumstantial change" would be applicable to a case where a contract has only become economically disadvantageous due to a change of economic circumstances, unless there is a special provision under the contract to release the parties from their obligations in such a case. According to Article 29 of the PAMF, the contractor may make a claim to change the construction price in the construction contract to the fair value at the time of the claim if the construction price becomes clearly unsuitable due to a sudden change of economic circumstances.

3.13 Are parties, who are not parties to the contract, entitled to claim the benefit of any contractual right which is made for their benefit? E.g. is the second or subsequent owner of a building able to claim against the contractor pursuant to the original construction contracts in relation to defects in the building?

In general, under the Civil Code, only the contracting parties are entitled to claim contract rights. However, if they designate a third party as a beneficiary and such beneficiary has expressed its intention to the obligor to enjoy the benefit, such beneficiary will be entitled to claim the benefit made under the contract (such contract is categorised as a “contract for a third-party beneficiary” (*daisansha no tame ni suru keiyaku*) under the Civil Code). In practice, a *daisansha no tame ni suru keiyaku* is not used in construction contracts to benefit the second or subsequent owners of a building.

3.14 On construction and engineering projects in your jurisdiction, how common is the use of direct agreements or collateral warranties (i.e. agreements between the contractor and parties other than the employer with an interest in the project, e.g. funders, other stakeholders, and forward purchasers)?

In Japan, it has not been common to use direct agreements or collateral warranties on construction and engineering projects. Recently, however, direct agreements have been seen more often than before.

3.15 Can one party (P1) to a construction contract, who owes money to the other (P2), set off against the sums due to P2 the sums P2 owes to P1? Are there any limits on the rights of set-off?

Under the Civil Code, unless otherwise provided by a special agreement under a contract, P1 may freely set off obligations which P1 owes to P2 due to a construction contract or any other cause (except for obligations arising from tortious acts committed in bad faith or causing death or injury to person) against obligations of the same sum which P2 owes to P1 due to a construction contract or any other cause, as long as the requirements for set-off (e.g., the obligation which P2 owes to P1 is due, etc.) are satisfied. There is no provision in the PAMF limiting the rights of set-off.

3.16 Do parties to construction contracts owe a duty of care to each other either in contract or under any other legal doctrine? If the duty of care is extra-contractual, can such duty exist concurrently with any contractual obligations and liabilities?

There is no express provision in relation to a duty of care in the “contracts for work” (*ukeoi*) section under the Civil Code. Under the Civil Code, a contractor owes a duty to the employer to complete its work and the employer owes a duty to the contractor to pay the construction costs for the completed work. However, there is a precedent where the court approved the concept that the contractor, as an expert, owes a duty to research the ordered content and owes a duty to provide information (including giving advice and explanation) to the employer as a supplementary duty based on the “principle of good faith” (*shingi-soku*) (Nagoya Dist. Ct., Judgment of 15 September 2006, 1243 Hanrei Times 145) and there may be situations where the contractor owes a certain duty of care before the completion of the work. The duty of care mentioned above can exist concurrently with contractual obligations and liabilities set out under a construction contract.

3.17 Where the terms of a construction contract are ambiguous, are there rules which will settle how that ambiguity is interpreted?

There is no particular rule that will be applicable when the terms of a construction contract are ambiguous (e.g., *contra proferentem*). As mentioned in question 3.3, the terms of a contract are interpreted by considering (a) the purpose of the parties, (b) the circumstances of entering into such contract, (c) customs, and (d) transaction conventions and, in some circumstances, the terms may be interpreted by reference to situations outside of the contract and not limited to the terms of the contract.

3.18 Are there any terms which, if included in a construction contract, would be unenforceable?

In general, construction contracts are executed to bind the other party to duties which are enforceable. Therefore, except for cases where such duties are void due to violation of public policy (*koujiyo ryousaku*), or where there is a cause for cancellation, such contracts are enforceable.

3.19 Where the construction contract involves an element of design and/or the contract is one for design only, are the designer’s obligations absolute or are there limits on the extent of his liability? In particular, does the designer have to give an absolute guarantee in respect of his work?

According to case law, in relation to design and supervision duties, designers are said to bear an advanced and broad duty of care regarding the safety of buildings (Sup. Ct., Judgment of 6 July 2007, 1984 Hanrei Jiho 34). However, such duty of care does not necessarily mean an absolute or unlimited obligation. While there are no clauses in the PAMDSA which indemnify or mitigate the obligation of the designer in relation to deliverables, likewise there are no clauses which increase the obligation of the designer compared with the general obligation for non-performance.

3.20 Does the concept of decennial liability apply in your jurisdiction? If so, what is the nature of such liability and what is the scope of its application?

There is no concept of decennial liability in our jurisdiction.

4 Dispute Resolution

4.1 How are construction disputes generally resolved?

In general, parties who cannot resolve a dispute by consultation will use court procedures or alternative dispute resolution (“ADR”). According to Article 34 of the PAMF, if a dispute related to a construction contract arises, the parties will first request a third party appointed by both parties to resolve the dispute, or they will seek to resolve the dispute by mediation or conciliation through the “Construction Dispute Commission” (*kensetsu koji funsou shinsakai*) (the “CDC”), which is an ADR body established based on the CBA that resolves disputes related to construction contracts. If such dispute cannot be resolved through the above-mentioned proceedings, the dispute will be resolved by either an arbitration proceeding held by the CDC acting as the arbitral tribunal, or by court procedures.

4.2 Do you have adjudication processes in your jurisdiction (whether statutory or otherwise) or any other forms of interim dispute resolution (e.g. a dispute review board)? If so, please describe the general procedures.

Under Japanese law, there is a procedure similar to the adjudication process called “civil mediation”, which is a method of ADR different from court proceedings and arbitration. However, since civil mediation can only be reached by an agreement between both parties, it is not the same as the adjudication process used in, e.g., the United Kingdom. Though a court can make an order *in lieu* of mediation if there is no chance that the parties would enter into an agreement, this order will cease to be effective if either party disagrees with the order.

4.3 Do the construction contracts in your jurisdiction commonly have arbitration clauses? If so, please explain how, in general terms, arbitration works in your jurisdiction.

In practice, it is not common for construction contracts to have arbitration clauses. Under the PAMF, if the ADR process summarised in question 4.1 fails, the parties may choose either arbitration or court proceedings. If arbitration is chosen and parties enter into an arbitration agreement, under the Japanese Arbitration Act (Act No. 138 of 2003, as amended, the “**Arbitration Act**”), the arbitration proceedings will start with one of the parties filing a petition with the arbitral body pursuant to the agreement. Even if a party files a lawsuit with the court, the court must dismiss the case without prejudice if either party claims that there is an arbitration agreement between the parties. When the arbitration proceeding starts, arbitrators will be appointed pursuant to the arbitration agreement and an arbitral tribunal consisting of such arbitrators will hear the case and make an arbitral award. The arbitral award binds the parties under dispute and they may not file any objections to the arbitral body or to the court. A party wishing to execute an arbitral award must acquire an execution order from the court and carry out the execution pursuant to the Civil Execution Act (Act No. 4 of 1979, as amended).

4.4 Where the contract provides for international arbitration, do your jurisdiction's courts recognise and enforce international arbitration awards? Please advise of any obstacles (legal or practical) to enforcement.

Under the Arbitration Act, regardless of the place of arbitration (i) an arbitral award will be recognised by the competent Japanese court (i.e., become valid) without requiring any special action within Japan, and (ii) a party who wishes to execute an arbitral award can apply to the competent Japanese court for an execution order, and the court must issue such order, unless any of the following situations are applicable:

- (1) the arbitration agreement is not valid due to a limitation on the capacity to act (*kouji nouryoku*) of either party;
- (2) the arbitration agreement is not valid due to reasons other than a limitation on the capacity to act (*kouji nouryoku*) under the laws and ordinances designated by the parties as applicable to the arbitration agreement (in case there are no designated laws and ordinances, the laws and ordinances of the country of the place of arbitration will be applicable);
- (3) either party did not receive the required notice pursuant to the laws and ordinances of the country of the place of arbitration (if the parties entered into an agreement which agrees on matters concerning provisions unrelated to public

policy in such laws and ordinances, said agreement applies) during the appointment procedure of the arbitrator or the arbitration procedure;

- (4) either party was unable to participate in the arbitration procedure;
- (5) the arbitral award contains a decision on matters beyond the scope of the arbitration agreement or of the petition presented in the arbitration procedure;
- (6) the composition of the arbitral tribunal or the arbitration procedure is in violation of the laws and ordinances of the country of the place of arbitration (if the parties have reached an agreement on matters concerning provisions unrelated to public policy in such laws and ordinances, said agreement applies);
- (7) according to the laws and ordinances of the country of the place of arbitration (if the laws and ordinances applicable to the arbitration procedure are those of a country other than that of the place of arbitration, said other country's laws and ordinances apply) the arbitral award is not final and binding, or the arbitral award has been set aside or its effect has been suspended by a judicial body of that country;
- (8) the petition filed in the arbitration procedure is concerned with a dispute which may not be subject to an arbitration agreement pursuant to the provisions of Japanese laws and ordinances; or
- (9) the content of the arbitral award is contrary to public policy in Japan.

4.5 Where a contract provides for court proceedings in your jurisdiction, please outline the process adopted, any rights of appeal and a general assessment of how long proceedings are likely to take to reduce: (a) a decision by the court of first jurisdiction; and (b) a decision by the final court of appeal.

Under the Civil Procedure Act (Act No. 109 of 1998, as amended, the “**CPA**”), a civil lawsuit will start with the plaintiff filing a complaint with the competent court (usually the district court) and the court serving the complaint to the defendant. After proceedings, such as preparatory proceedings to marshal issues, pleadings, and the production of evidence, the court proceedings of the first jurisdiction will end with a judgment by the court. Parties who disagree with the judgment may appeal to the superior court (e.g., the high court), and, furthermore, parties who disagree with the judgment of the superior court may, generally only for reasons related to legal issues, appeal to the Supreme Court. According to research conducted by the Supreme Court of Japan, although the actual period depends on the individual matters of each case, the average timeline for a decision (a) by the court of first jurisdiction takes approximately nine months, and (b) by the final court of appeal takes approximately three years in total (however, lawsuits related to construction are likely to take more time than the average civil lawsuit).

4.6 Where the contract provides for court proceedings in a foreign country, will the judgment of that foreign court be upheld and enforced in your jurisdiction? If the answer depends on the foreign country in question, are there any foreign countries in respect of which enforcement is more straightforward (whether as a result of international treaties or otherwise)?

Under the CPA, a judgment of a foreign court (“**Foreign Judgment**”) will be upheld by the competent Japanese court (i.e., become valid) without requiring any special action within

Japan, unless such Foreign Judgment does not satisfy any of the conditions below. Also, under the CPA, a party who wishes to enforce a Foreign Judgment can apply to the competent Japanese court for an execution judgment and, in such case, the court must issue an execution judgment without examining the details of such Foreign Judgment, unless such Foreign Judgment is not final and binding or does not satisfy any of the following conditions:

- (1) the jurisdiction of the foreign court must be recognised pursuant to Japanese laws and ordinances, or applicable treaties;
- (2) the losing party must have been served (excluding service by publication or any other service similar thereto) with the

- requisite summons or order for the commencement of litigation, or have appeared without being so served;
- (3) the content of the judgment and the litigation proceedings must not be contrary to public policy in Japan; and
- (4) a mutual guarantee must be in place between Japan and the country where the Foreign Judgment is rendered (i.e., the courts of such country would enforce a similar judgment rendered by a Japanese court).

Since Japan is not a party or signatory to any of the international treaties for the reciprocal recognition and enforcement of Foreign Judgments, there is no particular foreign country from which judgments are enforced in a Japanese court in a more straightforward manner than any other country.



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COMAD, S.C.

1 Making Construction Projects

1.1 What are the standard types of construction contract in your jurisdiction? Do you have: (i) any contracts which place both design and construction obligations upon contractors; (ii) any forms of design-only contract; and/or (iii) any arrangement known as management contracting, with one main managing contractor and with the construction work done by a series of package contractors? (NB For ease of reference throughout the chapter, we refer to “construction contracts” as an abbreviation for construction and engineering contracts.)

Mexico has not developed a general standard type of construction contract (model contract), although some specific projects have used international forms such as FIDIC (*Fédération Internationale des Ingénieurs-Conseils*), AIA (American Institute of Architects – USA) and ConsensusDocs (USA). On the contrary, it is common for construction companies to use their own model contract for both construction (which are typically lump-sum or unit price contracts) and engineering and design (typically services contracts).

It is important to mention that in Mexico, the applicable law and the form of the contract will depend on whether is a public contract (executed between a private entity and the State) or a private contract (executed between private entities).

When the contract is formalised and executed with the Public Administration, the Public Works and Related Services Law (the LOPSRM) establishes the standards and/or minimum elements that the contracts governed by such law shall consider. (It is important to bear in mind that Mexico is a Federation comprised of 32 States and almost every State has its own regulation regarding Public Works, so the governing law will depend on whether or not the project is federal.)

On the other hand, when the contract is a private contract, according Mexican civil legislation, the parties are free to agree the terms and conditions of the contract as they wish, as long as they do not violate the public order/public interest rules. In this regard, regular types of construction contract include lump-sum, unit price, mixed (lump-sum and unit price) and, recently, more Construction Management contracts (at-risk or pure) have been used.

1.2 How prevalent is collaborative contracting (e.g. alliance contracting and partnering) in your jurisdiction? To the extent applicable, what forms of collaborative contracts are commonly used?

There are no collaborative contracting schemes used in Mexico; however, is common in public contracts for two or more companies

to bid jointly in order to work as a consortium. COMAD members have used NEC contracts in other jurisdictions.

1.3 What industry standard forms of construction contract are most commonly used in your jurisdiction?

There are no standard forms of construction contract used in Mexico but, as mentioned before, there are some types of contract in Mexico that are commonly used for construction, such as lump-sum and unit price contracts.

1.4 What (if any) legal requirements are there to create a legally binding contract (e.g. in common law jurisdictions, offer, acceptance, consideration and intention to create legal relations are usually required)? Are there any mandatory law requirements which need to be reflected in a construction contract (e.g. provision for adjudication or any need for the contract to be evidenced in writing)?

Pursuant to the Civil Code, a person is entitled by an offer only by making such offer, and if the offeror wants to take its offer down, it will have to do so via the same means of publicity through which the offer was made; additionally, civil legislation establishes that contracts are obligatory, since the parties agree on the price and the object without any formalisation needed.

In public projects, the formalities are stricter from the beginning of the binding process: for the contracting authority because it has to, *inter alia*, upload the project onto the electronic system (called “COMPRANET”); and for the participants in the tender process, since they have to submit a proposal. Additionally, there is a stage at which the participants have the opportunity to ask questions and clarify specific points on the project. Finally, the law establishes a time limit for the contract to be formalised.

It is relevant to mention that the general rule is that public construction projects shall be awarded through a bidding process; however, as an exception to the rule, public projects can be awarded directly or by a “restricted tendering” process. If this is the case, the contracting authority will have to comply with additional formalities such as the issuance of a report providing reasons which justify not using the regular open bid process.

Private projects are similar, but generally the owners of such projects carry out their own market research and directly invite companies which they consider fit to meet their requirements.

1.5 In your jurisdiction please identify whether there is a concept of what is known as a “letter of intent”, in which an employer can give either a legally binding or non-legally binding indication of willingness either to enter into a contract later or to commit itself to meet certain costs to be incurred by the contractor whether or not a full contract is ever concluded.

According to the Civil Code, there is a “contracting promise”, with the sole aim of formalising a contract in the future. By signing a contracting promise, the parties are only entitled to execute a future contract within a set period of time.

In any case, the “letter of intent” is a widely used document in the regular commercial construction market, and its enforceability depends very much on the content of the document.

1.6 Are there any statutory or standard types of insurance which it would be commonplace or compulsory to have in place when carrying out construction work? For example, is there employer’s liability insurance for contractors in respect of death and personal injury, or is there a requirement for the contractor to have contractors’ all-risk insurance?

There is statutory insurance for the contractor with respect to its employees under the Law of Social Security (for death, works risk, personal injury or sickness of the employees). Depending on the object of the contract, the parties can agree on different kinds of insurance that they deem necessary in order to perform the corresponding contract. The most common are: professional liability (design); civil liability; general liability (all-risk); automobile; equipment or machinery; environmental; construction; and work insurance. This also depends on the insurance required by the union contracted.

As for Public Work contracts, they usually force the contractor to provide insurance on certain matters in order to cover contingencies during the execution of the contract. Depending on the procurement entity, there will be additional requirements according to internal laws and regulations (Federal Commission of Electricity (CFE), Mexican Petroleum (PEMEX), *inter alia*).

1.7 Are there any statutory requirements in relation to construction contracts in terms of: (a) labour (i.e. the legal status of those working on site as employees or as self-employed sub-contractors); (b) tax (payment of income tax of employees); and/or (c) health and safety?

In public and private contracts, the general requirements are almost the same: not to agree against the rules of public order; to be in writing, etc. However, there are some specific things to bear in mind, such as:

- a) For labour matters: in the case of both public and private contracts, the construction contractor shall comply with all the labour requirements established by the Mexican Social Security Institute (IMSS); *inter alia*, the employers in the construction field shall comply with the “Obligatory Social Security Rules for Construction Workers contracted by Project or Determined Time”, which establish several obligations for construction employers, understood to mean either the owner of the project (in private contracts) or the contractor which will perform the project. Additionally, construction employers have to comply with the Federal Labour Law, which establishes the general requirements and employers’ obligations such as correct and punctual payment, union fees, social and security fees, etc.

- b) Tax: the tax field is very general and obliges the parties in construction contracts to pay their corresponding taxes.
- c) Health and safety: in terms of article 15-C of the Federal Labour Law, the employer is obliged to review the contractor’s compliance with the applicable measures for safety, health and environmental protection. In the “health” sector specifically, it is a matter of public knowledge that with the health crisis of 2020, several measures will have to be implemented in various sectors of the economy, construction being a key pillar of the economy. In this regard, the Mexican health authorities have issued protocols to be followed by companies in order to ensure a safe return to normal activities, which include maintaining social distancing, reducing the gathering of personnel in common areas, and putting a sanitising area at the entrance to the workplace. It is presumed that those measures will become permanent. It is also important to note that the measures to be taken will vary from one State to another.

1.8 Is the employer legally permitted to retain part of the purchase price for the works as a retention to be released either in whole or in part when: (a) the works are substantially complete; and/or (b) any agreed defects liability period is complete?

The Public Works and Related Services Law, specifically in its articles 46 and 46*bis*, empower the contractor to make retentions derived from subcontractors’ delays. Those retentions can be reintegrated if the subcontractor catches up to the schedule.

In private contracts, the parties are free to agree the terms of retentions and put these in the contract. It is also common to see similar practices in public contracts. Additionally, private contracts usually contemplate retentions as guarantees for hidden defaults, or even include bond policies in order to guarantee against hidden defaults.

1.9 Is it permissible/common for there to be performance bonds (provided by banks and others) to guarantee the contractor’s performance? Are there any restrictions on the nature of such bonds? Are there any grounds on which a call on such bonds may be restrained (e.g. by interim injunction); and, if so, how often is such relief generally granted in your jurisdiction? Would such bonds typically provide for payment on demand (without pre-condition) or only upon default of the contractor?

In Mexico, bonds are the most common way to guarantee the performance and general obligations under the contract.

For public contracts (even for Public Works and/or related services), providing a bond policy is indeed a legal requirement for the contractor (article 48 of the LOPSRM). In general, the amount of the bond in public contracts is not higher than 10 per cent of the total amount of the contract. As for private contracts, the parties are free to agree on the amount of the bond, and it is common for the bond policies issued to amount to 30 to 50 per cent of the total amount of the contract.

In Mexico, there is the Insurance and Bond Institutions General Law, which establishes a summary procedure in order to claim for the bond, whereby the bonding company can request additional information only once and issue a resolution. The only requirement of such law is that the Claimant of the bond prove the existence and enforceability of the obligation guaranteed (article 279).

However, it is not common for bonding companies to pay the amounts required, and it should be noted that there is no unified judicial criteria determining when the bonding company does

or does not have to pay. Also, it is important to highlight that, for instance, bonding companies perform conciliating efforts resulting, on occasion, in amicable results between the parties in conflict.

On the other hand, there is a judicial instance where the bonding company resolution can be challenged, in which the trusted party is called to defend itself.

1.10 Is it permissible/common for there to be company guarantees provided to guarantee the performance of subsidiary companies? Are there any restrictions on the nature of such guarantees?

In public contracts, these kinds of guarantee are not commonly used. In private contracts, there is no restriction on including or using them.

1.11 Is it possible and/or usual for contractors to have retention of title rights in relation to goods and supplies used in the works? Is it permissible for contractors to claim that, until they have been paid, they retain title and the right to remove goods and materials supplied from the site?

It is not common practice to include these provisions in construction contracts, but we have seen it in a couple of instances. Nevertheless, article 2644 of the Civil Code mentions that when the contractors have not been paid, they can retain the work that has been constructed, but it does not mention the right to retain the title or to remove goods. The only case in which this would be possible is if the parties expressly agree and establish it as a contract clause.

2 Supervising Construction Contracts

2.1 Is it common for construction contracts to be supervised on behalf of the employer by a third party (e.g. an engineer)? Does any such third party have a duty to act impartially between the contractor and the employer? If so, what is the nature of such duty (e.g. is it absolute or qualified)? What (if any) recourse does a party to a construction contract have in the event that the third party breaches such duty?

It is common for construction contracts to be supervised by a third party on behalf of the owner, usually known as the “supervisor”. Third parties are supposed to act impartially, but in practice it is common for them to act on behalf of the owner’s interests. Usually the engineer or architect may provide elements for the employer to decide on the completion of the works.

Since there is no privity between the contractor and the supervisor, it is uncommon for a contractor to sue the supervisor or *vice versa*.

2.2 Are employers free to provide in the contract that they will pay the contractor when they, the employer, have themselves been paid; i.e. can the employer include in the contract what is known as a “pay when paid” clause?

According to article 1839 of the Civil Code, if the parties consider a “pay when paid” clause essential to their contract, they are free to agree on it.

2.3 Are the parties free to agree in advance a fixed sum (known as liquidated damages) which will be paid by the contractor to the employer in the event of particular breaches, e.g. liquidated damages for late completion? If such arrangements are permitted, are there any restrictions on what can be agreed? E.g. does the sum to be paid have to be a genuine pre-estimate of loss, or can the contractor be bound to pay a sum which is wholly unrelated to the amount of financial loss likely to be suffered by the employer? Will the courts in your jurisdiction ever look to revise an agreed rate of liquidated damages; and, if so, in what circumstances?

Liquidated damages are the most commonly used sanction for breaches of contract under Mexican law. The parties can agree in advance a certain sum to be paid in the event of particular breaches, or in the cases agreed by them. However, this kind of provision has some restrictions. In private contracts, the amount of liquidated damages cannot exceed the value of the breached obligation, and in public contracts, liquidated damages cannot exceed the amount of the performance bond.

If a contractor wants to claim for liquidated damages, these have to be determined and duly proved. If the court considers that the damages have not been duly proved, it will not award the payment of such damages.

In public contracts, in addition to liquidated damages, the contracting Authority has the legal right and obligation to initiate “termination for breach” procedures, which can lead to administrative fines, including debarment from participating in public bid procedures for a certain period of time.

3 Common Issues on Construction Contracts

3.1 Is the employer entitled to vary the works to be performed under the contract? Is there any limit on that right?

For public contracts, article 59 of the Public Works and Related Services Law allows the authority to modify the scope of the work, yet there are some limits on this right: variation in the scope is the responsibility of the authority, and the determination must be supported and establish the impact on the price and payment terms; such modification can neither vary the contract term or price by more than 25 per cent, nor modify the original project substantially.

If the changes exceed the mentioned percentage but do not vary the object of the contract, the parties can execute a Change Order, which will be considered part of the contract. Public lump-sum contracts cannot be modified when the total price or term is affected.

Regarding private contracts, articles 2623 and 2627 of the Civil Code provide that in a lump-sum contract, the employer is entitled to vary the scope of the work. In this type of contract, it is essential that the parties agree on the terms and conditions of the Change Order, due to all the changes that may be involved (in terms of payment and time).

When executing a Change Order, it is important to verify that the new terms do not conflict with contractual provisions, but also comply with applicable laws and regulations (e.g. the Construction Regulations).

3.2 Can work be omitted from the contract? If it is omitted, can the employer carry out the omitted work himself or procure a third party to perform it?

According to article 1796 of the Civil Code, the contract shall be performed in the manner agreed. However, such legislation, in article 2027, establishes that if the subcontractor omits the performance of certain work or if it is not performed as agreed, the employer can do it himself or hire a third party to do it at the subcontractor's expense. Since the Civil Code applies supplementarily to the Public Works and Related Services Law, the aforementioned articles are applicable to public contracts.

3.3 Are there terms which will/can be implied into a construction contract (e.g. a fitness for purpose obligation, or duty to act in good faith)?

For public contracts governed by the Public Works and Related Services Law and its secondary regulation, such legislation is automatically applicable, even where the contract does not regulate something specifically or it is ambiguous.

Concerning private contracts, according to article 1796 of the Civil Code, the parties are not only subject to the terms of the contract, but also to the consequences of the nature of the contract, its uses, good faith and the law. Also, the parties may choose a specific piece of legislation to apply to the contract; for example, the Civil Code of the respective State and/or the Commercial Code. In any case, if there is a controversy, the general rules of the contract established in the Civil Code shall apply.

3.4 If the contractor is delayed by two concurrent events, one the fault of the contractor and one the fault or risk of his employer, is the contractor entitled to: (a) an extension of time; and/or (b) the costs arising from that concurrent delay?

In public contracts, article 46*bis* of the Public Works and Related Services Law mentions that if the delay is caused by the contractor, the contractual penalties will apply, as long as they do not exceed the total price of the contract. In that case, there will not be an extension of time unless the parties agree to it.

If the delays are caused by the employer, the contractor is entitled to receive either: (i) the costs occasioned by the delay; or (ii) an extension of the final deadline in the same proportion of the delay, pursuant to article 52 of the Law.

In cases where there are two events that cause the delay, the affected party can allege a concurrent delay; nevertheless, this has to be proven, notwithstanding that the law is silent on this matter.

For private contracts, since there is a lack of regulation on this matter in the Civil Code, the parties are free to agree on the terms; however, as regards the costs occasioned, article 1840 states that the parties can agree on liquidated damages in the case that one of them does not comply with its obligations, which may result in a delay.

3.5 Is there a time limit beyond which the parties to a construction contract may no longer bring claims against each other? How long is that period and when does time start to run?

The general period under Mexican law is 10 years. For private contracts, the time limit to claim for hidden defaults is six months, which start to count from when the object of the contract is given (article 2149 of the Civil Code).

For public contracts, article 66 of the Public Works and Related Services Law establishes that the subcontractor will respond to hidden defects and any other liability incurred. Additionally, such article establishes that the subcontractor shall guarantee the works for 12 months by taking out a bond (equivalent to 10 per cent of the total amount of the contract) or through a credit letter (equivalent to 5 per cent of the total amount of the performed works).

3.6 Which party usually bears the risk of unforeseen ground conditions under construction contracts in your jurisdiction?

According to the Civil Code (article 2617), the contractor will bear the risk when this occurs before the completion of the works, unless otherwise agreed by the parties. This article shall apply to public contracts; however, there is some ambiguity as to its duration.

3.7 Which party usually bears the risk of a change in law affecting the completion of the works under construction contracts in your jurisdiction?

Regarding public contracts, article 67 of the Public Works and Related Services Law establishes that the contractor is the only one responsible for adherence to the law.

With respect to private contracts, in lump-sum agreements, all the risks that may arise during construction will be borne by the contractor (article 2617 of the Civil Code), including changes of law. For this reason, it is important to negotiate risk allocation while drafting the contract.

3.8 Which party usually owns the intellectual property in relation to the design and operation of the property?

For public contracts, according to article 46 of the Public Works and Related Services Law, the employer owns the intellectual property rights, except where there is an impediment.

In the case of private contracts, it is common for the contractor to keep its intellectual property; however, the parties are free to agree on this, and it will depend on the specific project.

3.9 Is the contractor ever entitled to suspend works?

Even though it is rare to see this, the Civil Code empowers the contractor to suspend the works when it is not paid or when a situation of *force majeure* arises (hardship). Both private and public contracts usually have a *force majeure* clause.

3.10 Are there any grounds which automatically or usually entitle a party to terminate the contract? Are there any legal requirements as to how the terminating party's grounds for termination must be set out (e.g. in a termination notice)?

In the case of public contracts, it is possible for the administration to terminate the contract unilaterally when it has demonstrated that continuing with the project would adversely affect the Mexican State. It has also been established that the contractor can terminate the contract strictly due to *force majeure* issues (articles 60 and 62 of the Public Works and Related Services Law, respectively).

For private contracts, the general rule (article 1797 of the Civil Code) establishes that an agreement cannot be terminated unilaterally. However, the same legislation establishes that the parties can agree on a manner to terminate the contract without judicial intervention (article 1941 of the Civil Code) or, in case of breach of contract, the affected party can request the termination of the contract plus the payment of losses and damages (article 1949). Please note that these articles are supplementarily applicable to public contracts.

It is important to be clear when agreeing the causes of termination of the contract, so that the parties can perform clearly in situations when this applies.

3.11 Do construction contracts in your jurisdiction commonly provide that the employer can terminate at any time and for any reason? If so, would an employer exercising that right need to pay the contractor's profit on the part of the works that remains unperformed as at termination?

Regarding public contracts, since these are governed by the Public Works and Related Services Law, the owner/employer is always empowered to terminate the contract when continuing with the project could adversely affect the Mexican State.

As stated above, in private contracts, this condition needs to be clearly agreed between the parties. In this regard, when the employer terminates the contract unilaterally for convenience, the contractor has the right to claim the payment of the works performed, pending estimations, known as “non-recoverable costs”.

In both cases, the owner can claim for the damages and losses that the unperformed works may generate.

3.12 Is the concept of *force majeure* or frustration known in your jurisdiction? What remedy does this give the affected party? Is it usual/possible to argue successfully that a contract which has become uneconomic is grounds for a claim for *force majeure*?

Force majeure is recognised in our jurisdiction as an event that is not foreseeable and where the party is unable to prevent it from happening.

Given the nature of such events, it is not possible to ask for liquidated damages (article 1847 of the Civil Code), unless one of the parties had the opportunity to prevent the *force majeure* and did not act accordingly. Also, if the *force majeure* is duly proved, the affected party can be released from what could have constituted a breach of a specific obligation.

According to article 62 of the Public Works and Related Services Law, it is possible in public contracts to argue that a *force majeure* event caused the impossibility to continue with the works, bringing about the early termination of the contract.

Case law states that for an event to be considered *force majeure*, it is not enough reason that compliance with the terms of the contract turns out to be more complicated or burdensome than foreseen, but rather that it is impossible for the works to be completed.

3.13 Are parties, who are not parties to the contract, entitled to claim the benefit of any contractual right which is made for their benefit? E.g. is the second or subsequent owner of a building able to claim against the contractor pursuant to the original construction contracts in relation to defects in the building?

As a general rule, it is an essential element to formalise and execute

an agreement with the will of the contracting parties (article 1794 of the Civil Code). Additionally, as a general rule, only the contracting parties are entitled to the contract (article 1796 of the Civil Code). In this regard, unless the parties agree on third-party rights, only the contracting parties are entitled to the contract (article 1869 of the Civil Code).

3.14 On construction and engineering projects in your jurisdiction, how common is the use of direct agreements or collateral warranties (i.e. agreements between the contractor and parties other than the employer with an interest in the project, e.g. funders, other stakeholders, and forward purchasers)?

It is common for the contractor (understood as the Project Manager) to agree with the subcontractors with regard to who will respond to the owner/employer directly, since it is not common to see the stakeholder involved directly in the management of the project. In fact, it is common for the contractor to agree with the subcontractors that the latter will hold the contractor to be harmless before the employer.

3.15 Can one party (P1) to a construction contract, who owes money to the other (P2), set off against the sums due to P2 the sums P2 owes to P1? Are there any limits on the rights of set-off?

In terms of the Civil Code, in these cases, it is possible for the parties to set off the debts up to the amount of the lowest one (articles 2185 and 2186 of the Civil Code). The limitations to this right are expressly established in article 2192.

3.16 Do parties to construction contracts owe a duty of care to each other either in contract or under any other legal doctrine? If the duty of care is extra-contractual, can such duty exist concurrently with any contractual obligations and liabilities?

Parties owe a duty of care to each other, considering that they are professionals performing valid work under the law. Additionally, the managing of a project can be understood as carrying out someone else's business. In this regard, the Project Manager shall act with the same care as if it were managing its own business, and that could be understood as a duty of care.

A lack of a duty of care will impact on the performance of the contract and could cause a possible breach by the person that does not comply correctly.

These kinds of duty of care cannot be “extracontractual” since they imply a “sanction” or obligation for a specific party. However, it is common to agree on a “damage and losses” clause, which usually covers violation of the duty of care.

In any case, breach of the duty of care can constitute legal grounds for the other party to start any claim or lawsuit in order to claim for damages.

3.17 Where the terms of a construction contract are ambiguous, are there rules which will settle how that ambiguity is interpreted?

In general, construction contracts (and every contract) contain the “applicable law” clause, which establishes that if anything is lacking in the contract, the particular rules of the applicable law agreed will apply.

In public contracts, if the contract lacks clarity, the Public Works and Related Services Law applies automatically. However, if such law is still ambiguous, the private contract rules are applicable. Such rules are as follows: (i) the ambiguous term must be interpreted in accordance with the other conditions of the contract, but also applying the sense that is consistent with the object and purpose of the contract; (ii) the customary practice of the country of the party must be taken into consideration; and (iii) if it is impossible to resolve the doubt through these rules, it will be resolved in favour of the greater reciprocity of interests (articles 1851 to 1857 of the Civil Code).

3.18 Are there any terms which, if included in a construction contract, would be unenforceable?

The general rule is that the will of the contracting parties is the law that will govern the contract, the limit of such will being the rules of public order and of general interest, so the parties cannot agree against them, under the penalty that the clauses agreed against the rules of public order and of general interest are not valid. In this regard, the articles and body of the contracts are enforceable on the parties *per se*. According to article 1796 of the Civil Code, the contract is formally enforced on the contracting parties. According to this, the contract is enforceable from the moment it is executed.

For private contracts, it is illegal for parties to agree on illicit activities, since such clauses will not be enforceable.

3.19 Where the construction contract involves an element of design and/or the contract is one for design only, are the designer's obligations absolute or are there limits on the extent of his liability? In particular, does the designer have to give an absolute guarantee in respect of his work?

The designer's obligations are not absolute with regard to situations in which a construction contractor incurs a fault for construction reasons and not due to design factors.

3.20 Does the concept of decennial liability apply in your jurisdiction? If so, what is the nature of such liability and what is the scope of its application?

Decennial liability applies differently according to the State where it is applied. In the Mexico City Civil Code, it applies to defects, flaws and incorrect performance according to article 2634.

4 Dispute Resolution

4.1 How are construction disputes generally resolved?

In Mexico, the most common way of solving disputes is litigation; however, arbitration and negotiation are gaining ground, especially for complex projects in sectors such as large-scale construction, energy and oil.

In public contracts, the parties can agree on arbitration by way of dispute resolution (as a so-called conciliation that is undertaken before the Ministry of Public Function) but termination of a contract by the Contracting Entity is excluded from the subjects eligible for arbitration (article 98 of the Public Works and Related Services Law).

4.2 Do you have adjudication processes in your jurisdiction (whether statutory or otherwise) or any other forms of interim dispute resolution (e.g. a dispute review board)? If so, please describe the general procedures.

There is no "adjudication" as understood in the United Kingdom, Australia or Malaysia. However, parties may agree to submit their disputes to a Dispute Adjudication Board (DAB) as adjudication processes have a binding effect. It is important to note, however, that this is rather uncommon in Mexico due to the lack of regulation.

4.3 Do the construction contracts in your jurisdiction commonly have arbitration clauses? If so, please explain how, in general terms, arbitration works in your jurisdiction.

Many construction contracts have arbitration clauses and depend on the needs of the parties. Generally, when the parties are from different countries, it is common to see International Chamber of Commerce (ICC) or London Court of Arbitration (LCIA) arbitration clauses. When both parties are Mexican, there are other national chambers, such as the Mexican Arbitration Centre (CAM) and the Arbitration Centre of the Construction Industry (CAIC).

When the contract has an arbitration clause but neither the procedural rules nor the institute that will administrate the procedure are specified, the Commercial Code will apply, which adopted the United Nations Commission on International Trade Law (UNCITRAL) Model Law.

4.4 Where the contract provides for international arbitration, do your jurisdiction's courts recognise and enforce international arbitration awards? Please advise of any obstacles (legal or practical) to enforcement.

The Mexican jurisdiction has generally been pro-arbitration, and it seems that this trend is continuing, taking into account that Mexico is a signatory to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention) and the Panama Convention.

4.5 Where a contract provides for court proceedings in your jurisdiction, please outline the process adopted, any rights of appeal and a general assessment of how long proceedings are likely to take to reduce: (a) a decision by the court of first jurisdiction; and (b) a decision by the final court of appeal.

In cases related to construction, these are commercial matters. Usually, such matters are heard by civil or commercial courts through ordinary lawsuits, which are commonly solved in a year and a half (of course, this estimate depends on the complexity of the case). After this first judgment, there is the right to challenge such resolution through an appeal, in which the court of appeal essentially has full jurisdiction to review the case substantially. This procedure can last another 12 to 18 months.

Finally, there is a constitutional trial which is understood not as another instance, but as a constitutional review.

The entirety of the instances may take between two and four years.

4.6 Where the contract provides for court proceedings in a foreign country, will the judgment of that foreign court be upheld and enforced in your jurisdiction? If the answer depends on the foreign country in question, are there any foreign countries in respect of which enforcement is more straightforward (whether as a result of international treaties or otherwise)?

It will depend on the country; for example, the USA and Canada are “Mexican Partners” in the new United States-Mexico-Canada Agreement (USMCA). However, there is a procedure in which the foreign judgment has to be approved and recognised in the Mexican jurisdiction in order to be executed.



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Jeroen Berlage



Maartje Speksnijder

1 Making Construction Projects

1.1 What are the standard types of construction contract in your jurisdiction? Do you have: (i) any contracts which place both design and construction obligations upon contractors; (ii) any forms of design-only contract; and/or (iii) any arrangement known as management contracting, with one main managing contractor and with the construction work done by a series of package contractors? (NB For ease of reference throughout the chapter, we refer to “construction contracts” as an abbreviation for construction and engineering contracts.)

In the Netherlands, one could roughly distinguish integrated design and construct contracts, which place both design and construction obligations upon contractors, and traditional construction contracts, which only place the construction obligations upon contractors in accordance with the contract documents and (design) drawings prepared on account of, and prescribed by, the employer. In the event of ancillary activities to be performed by contractors assigned directly by the employer, contractors are usually bound by a multilateral coordination agreement, under which coordination of the ancillary activities is usually to the main contractor.

1.2 How prevalent is collaborative contracting (e.g. alliance contracting and partnering) in your jurisdiction? To the extent applicable, what forms of collaborative contracts are commonly used?

True collaborative contracting (e.g. “alliance contracting” and “partnering” – as it is understood in other countries) is still not very prevalent in the Netherlands, although it is gaining interest. This may have to do with the fact that the contract sum is not fixed, which as yet is considered to be too big a risk by most Dutch employers. Insofar as alliance contracting and partnering contracts are being concluded, these are tailor-made contracts and not based on a standard-form contract. A “building team” contract, however, is rather popular and often based on the Model Building-team Contract 1992. The contractor will provide its expertise on construction costs during the design phase, in return for which the contractor will be entitled to be the first to submit an offer. All parties to a building team are and remain liable for those (team) decisions that lie within their specific field of expertise, provided the (team) decision has expressly or tacitly been accepted by the relevant expert. If, for instance, the contractor suggests the use of materials or a construction method for cost-reduction purposes and the engineer accepts this as a structural design solution, the engineer

may be at fault and liable if that decision turns out to be a structural design fault.

1.3 What industry standard forms of construction contract are most commonly used in your jurisdiction?

The Dutch Civil Code (“DCC”) is divided into books, with a special chapter in book 7 reserved for construction contracts (Title 12 Book 7 clauses 7:750 DCC and further) and a special chapter reserved for services (Title 7.7. Book 7 clauses 7:400 and further). Most construction and service contracts, however, are based on standard-form contracts and conditions, which have been construed by all major stakeholders and branch organisations and are considered to be well balanced and just. As a general principle, contracting authorities are obliged to apply these conditions without amendments if the Dutch Public Procurement Act 2012 (“*Aanbestedingswet 2012*”) applies.

There are a number of these standard-form construction contracts used in the Netherlands. The most commonly used forms are the Uniform Administrative Conditions 2012 (“UAC”) for construction only, the New Rules 2011 for design and/or project management services only, and the Uniform Administrative Conditions for integrated contracts (“UAC-IC 2005”) for design and construct contracts. International forms such as JCT and NEC are hardly ever used, although the use of FIDIC forms may sometimes be preferred by international employers.

1.4 What (if any) legal requirements are there to create a legally binding contract (e.g. in common law jurisdictions, offer, acceptance, consideration and intention to create legal relations are usually required)? Are there any mandatory law requirements which need to be reflected in a construction contract (e.g. provision for adjudication or any need for the contract to be evidenced in writing)?

As a general principle, there is no prescribed form to constitute a legally binding construction contract, nor are there any mandatory law requirements which need to be reflected in a construction contract. A contract is concluded by an offer and its acceptance, regardless of its form.

1.5 In your jurisdiction please identify whether there is a concept of what is known as a “letter of intent”, in which an employer can give either a legally binding or non-legally binding indication of willingness either to enter into a contract later or to commit itself to meet certain costs to be incurred by the contractor whether or not a full contract is ever concluded.

An “LOI” may be issued to indicate an intention to enter into a contract in due course, but an LOI is not a legal definition or term in the Netherlands, and as a general principle an LOI does not constitute a legally or non-legally binding indication of willingness to enter into a contract. This may of course be different if parties already agree in an LOI to most of the essential elements of a contract, such as time, scope and contract price. It most often, however, serves no real purpose other than to allow the possible employer an exclusivity period and to bring about some obligation to negotiate in good faith.

1.6 Are there any statutory or standard types of insurance which it would be commonplace or compulsory to have in place when carrying out construction work? For example, is there employer’s liability insurance for contractors in respect of death and personal injury, or is there a requirement for the contractor to have contractors’ all-risk insurance?

Dutch statutory law does not require specific insurance in relation to construction projects, save for motor vehicle insurance where appropriate. However, construction projects will typically involve:

- (a) insurance of the project works (typically referred to as “All Risks” insurance), taken out by either the contractor or the employer to cover loss or damage to the works and/or project materials and/or damage to existing properties of the employer;
- (b) employer’s liability insurance, taken out by the contractor to cover injury to or death of its employees during the course of a construction project;
- (c) public liability insurance, taken out by the contractor to cover third-party claims in relation to personal injury, death or injury to third parties and property damage (other than damage to the works); and
- (d) professional indemnity (“PI”) insurance, taken out by any party with design responsibility, to cover design liability.

1.7 Are there any statutory requirements in relation to construction contracts in terms of: (a) labour (i.e. the legal status of those working on site as employees or as self-employed sub-contractors); (b) tax (payment of income tax of employees); and/or (c) health and safety?

Labour law

According to article 2 of the Foreign National Act (in Dutch: *Wet arbeid vreemdelingen*, “Wav”), a work permit is, in principle, required for non-EU/EEA employees working in the Netherlands. Please be aware that as of 1 January 2021, British nationals will also be considered non-EU/EEA employees and will therefore, in principle, require a work permit to be able to work in the Netherlands. Failure to comply can lead to chain liability for all parties that work in the chain related to a specific project and is not limited to the formal employer of the foreign worker. Most contracts include indemnification and wording that any penalty will be charged to the other party. One should be aware of the specific identification requirements which apply to the hiring and lending of foreign nationals (article 15 Wav).

The main employer, in addition to the labour employer, is jointly and severally liable to the employee for payment of the employee’s wage (article 7:616a DCC). There is also a chain liability for other clients and parties in the chain and the employee can hold every (next higher) client in the chain liable for payment of his wages (article 7:616b DCC).

Furthermore, a collective bargaining agreement (“CAO”) could apply to the work. Although the CAO Bouw & Infra, the collective bargaining agreement for construction and infrastructure projects, is currently not declared generally binding, employers may still apply this CAO. In such a case, the provisions of this collective bargaining agreement shall have to be applied. To avoid, *i.a.*, reputational risk, if contractors apply the CAO to their employees it is advisable to ensure that they respect all CAO conditions.

Tax

In accordance with the Dutch Collection of State Taxes Act 1990 (*Invorderingswet 1990*), (main) contractors or so-called “self-contractors” are jointly and severally liable for unpaid wage tax and national insurance contributions due at the level of any – directly or indirectly – engaged subcontractor (so-called “vicarious tax liability” or “chain liability”).

Chain liability arises (i) if and to the extent that a (sub) contractor carries out tangible works (including construction, repair, cleaning, maintenance, alteration and demolition services, and the handing over of construction works), and (ii) if the principal acts as a main contractor, subcontractor or self-contractor.

The risk of vicarious tax liability or chain liability can be reduced by opening and paying sufficient amounts into a so-called G-account. A G-account is a frozen account that can only be used to pay wage taxes and national insurance contributions to the Dutch Tax Authorities.

Health and safety

With regard to health and safety, the Working Conditions Act is applicable. The Working Conditions Act contains specific provisions for clients in the construction industry. These are elaborated in the construction process provisions of the Working Conditions Decree. Failure to comply may lead to fines and/or liability in case of working accidents or in case of breach of the provisions.

1.8 Is the employer legally permitted to retain part of the purchase price for the works as a retention to be released either in whole or in part when: (a) the works are substantially complete; and/or (b) any agreed defects liability period is complete?

Even without invoking the right to withhold payment due to partial or improper performance by the contractor, and with preservation of his right to claim the delivery of the completed construction project, a *natural employer* who does not act in the course of a professional practice or business may – pursuant to article 7:768 DCC – withhold up to 5% of the contract price for the construction of a house from the last payable instalment or instalments, and deposit this amount in an account of a notary instead of paying it to the contractor. If parties agreed to a defects liability period, the employer may withhold payment until the end of the defects liability period. Standard conditions such as the UAC 2012 have a similar clause for *professional employers*. In any case, most employers tend to withhold payment of the last instalment, sometimes in addition to a performance guarantee. The contractor is likely to prefer payment in full before handover and issue a performance bond as security for the defects liability period to avoid i) demand on working capital, and ii) risk of recovery.

1.9 Is it permissible/common for there to be performance bonds (provided by banks and others) to guarantee the contractor's performance? Are there any restrictions on the nature of such bonds? Are there any grounds on which a call on such bonds may be restrained (e.g. by interim injunction); and, if so, how often is such relief generally granted in your jurisdiction? Would such bonds typically provide for payment on demand (without pre-condition) or only upon default of the contractor?

Performance bonds and parent company guarantees are permissible and very customary in the Netherlands, and there are no restrictions on the nature of such bonds by law. The guarantee usually amounts to 10% of the contract sum to be issued at the effective date and is reduced at handover for the remainder of the defects liability period. Most employers will ask for an on-demand bond. Quite often, contractors are allowed to have a bond company that does not require a counter guarantee to issue a bond, instead of having a bank issue a bank guarantee that demands working capital.

1.10 Is it permissible/common for there to be company guarantees provided to guarantee the performance of subsidiary companies? Are there any restrictions on the nature of such guarantees?

Dutch law does not contain any statutory provisions that impose liability on a parent company for the acts of its affiliates or group companies. Dutch law requires each limited liability company to make its annual accounts publicly available by filing them at the Trade Register of the Chamber of Commerce. A parent company exercising control over other entities is also required to publish annual accounts consolidating the assets, liabilities and results of the group. The subsidiaries concerned may choose not to publish their stand-alone accounts as required by law. In such event, the parent company concerned is required to file a liability statement whereby it assumes a joint and several liability for the legal acts undertaken by such subsidiaries during the lifetime of the statement (the so-called 403 statement). The 403 statement is available for public inspection and third parties may rely on it; the liability of the parent company constitutes an independent obligation towards the creditor.

A contractually agreed parent company guarantee will come directly from the parent company, where the contractor is a subsidiary of the parent company and will cover the entirety of the works. Company guarantees are often capped at the contract sum.

1.11 Is it possible and/or usual for contractors to have retention of title rights in relation to goods and supplies used in the works? Is it permissible for contractors to claim that, until they have been paid, they retain title and the right to remove goods and materials supplied from the site?

Ensnuing from article 3:290 DCC, the contractor has the right of retention. The contractor has to have actual control over the work; the employer may have some minor work realised by other contractors but such contractors must not be considered to have taken over control. The contractor may fence off the work and give notice to third parties that the contractor is evoking his right to retention with respect to (parts of) the works.

Most employers, however, will have the contractor waive its right of retention, especially when a completion guarantee is to be provided by the contractor for the benefit of the financier, since the contractor may also enforce his right against a financier.

2 Supervising Construction Contracts

2.1 Is it common for construction contracts to be supervised on behalf of the employer by a third party (e.g. an engineer)? Does any such third party have a duty to act impartially between the contractor and the employer? If so, what is the nature of such duty (e.g. is it absolute or qualified)? What (if any) recourse does a party to a construction contract have in the event that the third party breaches such duty?

It is common for construction contracts to be supervised on behalf of the employer by a third party, such as an architect, an engineer or a contract manager. The third party acts on behalf of the employer, as a representative, and is not impartial. The third party may in fact have been involved in, or even responsible for, the design giving cause for dispute.

2.2 Are employers free to provide in the contract that they will pay the contractor when they, the employer, have themselves been paid; i.e. can the employer include in the contract what is known as a "pay when paid" clause?

Parties have freedom of contract and may agree to include a "pay when paid" clause, although large companies may no longer apply payment terms longer than 60 days in contracts with SME entrepreneurs. Any clause *ipso facto* stipulating a longer term is void and the payment term will be considered to be 30 days by operation of law.

2.3 Are the parties free to agree in advance a fixed sum (known as liquidated damages) which will be paid by the contractor to the employer in the event of particular breaches, e.g. liquidated damages for late completion? If such arrangements are permitted, are there any restrictions on what can be agreed? E.g. does the sum to be paid have to be a genuine pre-estimate of loss, or can the contractor be bound to pay a sum which is wholly unrelated to the amount of financial loss likely to be suffered by the employer? Will the courts in your jurisdiction ever look to revise an agreed rate of liquidated damages; and, if so, in what circumstances?

Parties have freedom of contract. A fixed-sum penalty (also known as liquidated damages) to be paid by the contractor to the employer in the event of particular breaches, e.g. a fixed-sum penalty for late completion, is very customary, albeit a difficult topic during contract negotiations. A fixed-sum penalty will, in principle, preclude the employer from additionally claiming "real" damages relating to the breach sanctioned with the fixed-sum penalty. Parties can, however, contractually agree that a fixed-sum penalty exists in addition to the right of the employer to claim real damages from the contractor.

There is no requirement in law for a fixed-sum penalty to be a genuine pre-estimate of loss and it can, in principle, be unrelated to the financial loss likely to be suffered by the employer. Paragraph 42 of the UAC 2012 provides a standard penalty of €60 per day for late completion; if the amount is not adjusted, then that will be the maximum penalty, regardless of the actual damages or contract price. Courts will cautiously assess and not easily set aside a liquidated damages clause.

3 Common Issues on Construction Contracts

3.1 Is the employer entitled to vary the works to be performed under the contract? Is there any limit on that right?

The employer is, in principle, entitled to vary the works insofar as such variations are reasonable. This follows from the nature of a construction contract and articles 6:2 and 6:248 DCC, which apply to all contracts.

The UAC 2012 and the UAC-IC 2005 provide an extensive set of (additional) rules with regard to variations. § 36 UAC 2012 provides, amongst other things, that the contractor may refuse to accept variations to the works if, as a result of such changes, the total amount of additional payments and deductions each does not exceed 15% of the contract sum or, as the case may be, the balance of such additional payments and deductions does not exceed 10% of the contract sum.

3.2 Can work be omitted from the contract? If it is omitted, can the employer carry out the omitted work himself or procure a third party to perform it?

The employer has, in principle, the right to order part of the work to be omitted, and to carry out the omitted work himself or have a third party carry out the omitted work. The financial consequences of such an order depend on the contractual arrangements between parties and the specifics of the omitted work. If the UAC 2012 apply to the contract, the contractor may not accept such an order, in case the financial consequences thereof go beyond the above-mentioned thresholds (§ 36 UAC 2012). Without the employer's consent, the contractor is, in general, not entitled to refuse performance of part of the works assigned to it.

3.3 Are there terms which will/can be implied into a construction contract (e.g. a fitness for purpose obligation, or duty to act in good faith)?

In general, a contract has legal effect in accordance with its specific wording. In addition, terms are implied into the contract by virtue of law, custom and the principle of reasonableness and fairness.

Thus, in addition to the general rules for contracts set out in the DCC, the specific rules for construction contracts in articles 7:750–7:769 DCC will be implied (insofar as relevant), unless specifically agreed otherwise (provided that deviation from the specific provision of the DCC is not precluded). These articles provide, for example, rules with regard to liability for defects, rules with regard to completion of the works and an obligation for the contractor to warn the employer of noticeable mistakes in the assignment.

It follows from the principle of reasonableness and fairness that parties to a contract must act in a way that is reasonable and fair; a duty for both parties to act in good faith is therefore always implied.

Furthermore, it follows from standard case law that a contract must be interpreted not only on the basis of the wording thereof, but also looking at the intention of the parties and what both parties have and should have reasonably expected under the specific circumstances. This means that the reasonable expectations of parties are also implied into a contract.

3.4 If the contractor is delayed by two concurrent events, one the fault of the contractor and one the fault or risk of his employer, is the contractor entitled to: (a) an extension of time; and/or (b) the costs arising from that concurrent delay?

Pursuant to § 8 (5) UAC 2012, the contractor is entitled to an extension of the construction period and cost compensation if and to the extent that, due to (i) *force majeure*, (ii) circumstances for which the employer is responsible, or (iii) changes by or on behalf of the employer in the specification or in the execution of the works, it is not reasonably possible for the contractor to complete the works within the agreed term. There needs to be a causal link between such a cause of delay and the extra time and costs required to complete the works for a successful claim, in which case the contractor's right to an extension of time and cost compensation exists even if there is an additional (concurrent) cause of delay by the contractor.

The UAC-IC 2005 provide in § 44 that the contractor is only entitled to an extension of time and cost compensation if (and to the extent that):

- (a) the UAC-IC 2005 expressly provide for such cost compensation and/or extension and on condition that the costs and/or delay are caused by a circumstance that cannot be attributed to the contractor;
- (b) the costs and/or delay are caused by a circumstance for which the employer is responsible pursuant to the contract and for which the contractor did not have to warn the employer; or
- (c) an unforeseen circumstance arises, the nature of which is such that, according to the standards of good faith, the employer cannot expect the contract to be maintained unaltered.

The contractor can only successfully claim cost compensation and/or extension of time, on the basis of § 44 UAC-IC 2005, if he has notified the employer thereof in writing with due dispatch, stating the reasons. Again, this right of the contractor also exists if there is an additional cause of delay by the contractor.

3.5 Is there a time limit beyond which the parties to a construction contract may no longer bring claims against each other? How long is that period and when does time start to run?

Article 7:761 DCC provides that any claim arising out of a defect in the completed and delivered construction expires two years after the moment on which the employer has made a complaint about it. If the employer has given the contractor a period of time to repair the construction defect, the period of limitation starts to run at the end of that period or when the contractor has made clear that it will not repair the construction defect. A claim will, in any event, expire 20 years after completion if it concerns a building, and 10 years after completion of all other completed constructions.

The UAC 2012 and the UAC-IC 2005 provide a contractual expiry period of five years after completion or, in case the works have collapsed completely or partially, or threaten to collapse, or have come to be unfit or threaten to be unfit for the purpose for which they were intended, 10 years after completion.

3.6 Which party usually bears the risk of unforeseen ground conditions under construction contracts in your jurisdiction?

This depends on the specific distribution of responsibilities in the contract.

In a “traditional” construction contract to which the UAC 2012 apply, the employer will bear the responsibility – and therefore the risk – for the design and construction methods prescribed by him or on his behalf, including the effect that the ground conditions may have on that design and the construction methods. In line, § 29 (3) UAC 2012 provides that the contractor is entitled to claim additional payment if, during the execution of the works, the condition of the site appears to be different from that described in the specification and, owing to the nature of the consequences of such differences, it is not reasonable for the contractor to be accountable.

If the UAC-IC 2005 apply, the employer will be responsible for the contents of all information he provided to the contractor and thus will be liable if the information provided regarding the ground conditions turns out to be incorrect. § 13 (4) UAC-IC 2005 explicitly provides that the contractor is not liable for ground pollution discovered during the execution of works. However, this exclusion of liability of the contractor does not apply in case the contractor knew or should have known about the presence of the pollution before or at the time of formation of the contract (§ 13 (6) UAC-IC 2005).

3.7 Which party usually bears the risk of a change in law affecting the completion of the works under construction contracts in your jurisdiction?

Both the UAC 2012 and the UAC-IC 2005 provide that the employer bears the risk of changes in law impacting the work under the contract, unless it must reasonably be assumed that on the tender date the contractor could already have foreseen those consequences and unless the contract provides for specific provisions concerning the settlement of changes in wages/salaries and social security charges or of prices, rent and carriage costs.

3.8 Which party usually owns the intellectual property in relation to the design and operation of the property?

The authors of the copyright material created in respect of the design and operation of a property are, in most cases, the employer’s design consultants, or where a contractor has carried out design, the contractor or a combination of these. Such consultants and/or contractors will typically own the intellectual property rights in relation to the works.

§ 40 UAC-IC 2005 provides specific rules regarding the transfer of intellectual property rights of design documents. Under these rules, the employer shall become the owner of such documents and these may be used by him with due observance of the rights arising from intellectual property law, after the employer has met his financial obligations to the contractor. This paragraph further provides that the employer shall not be permitted to repeatedly reproduce the works as completed in accordance with the design documents – as part of an extension or otherwise – in whole or in part, without the express permission of the contractor. However, the employer shall be entitled to complete the works in accordance with the design documents, without the intervention and approval of the contractor, if the contract is terminated due to an attributable failure of the contractor.

3.9 Is the contractor ever entitled to suspend works?

The DCC provides that either party to a contract may suspend its performance in case of non-performance by the other party, provided that the obligations of the parties concerned are related

to each other in such a way that it is justified to suspend performance. This means, in general, that the contractor may suspend the execution of the works in case of non-payment (of a substantial amount) by the employer, unless this right is excluded in the contract.

3.10 Are there any grounds which automatically or usually entitle a party to terminate the contract? Are there any legal requirements as to how the terminating party’s grounds for termination must be set out (e.g. in a termination notice)?

Under Dutch law, the right to terminate a contract as from the day of termination (“*opzegging*”) must be distinguished from the right to terminate a contract with retroactive effect (“*ontbinding*”).

Typically, parties have the right to terminate with retroactive effect in case the other party is in default regarding the performance of its obligations under the contract. The party in default will then be liable for damages of the terminating party.

Under most standard contract forms, the employer will have the right to terminate a construction contract as from the day of termination at any time (without cause), while the contractor will in general not be entitled to terminate without cause. However, the UAC 2012 and UAC-IC 2005 provide that the contractor is entitled to terminate the contract in case the works are suspended for more than six months and in case the execution of the works is delayed for more than two months due to circumstances for which the employer is accountable. In case of such termination, i.e. “*opzegging*”, the employer will generally need to pay the contractor the full contract sum, minus the costs saved by the contractor due to not having to execute the remaining works. However, the exact calculation method for the amount to be paid differs, depending on whether this is governed by the UAC 2012, UAC-IC 2005 or the DCC.

3.11 Do construction contracts in your jurisdiction commonly provide that the employer can terminate at any time and for any reason? If so, would an employer exercising that right need to pay the contractor’s profit on the part of the works that remains unperformed as at termination?

Yes; see the answer to question 3.10. The contractor’s profit on the part of the works that remains unperformed will, in general, not qualify as saved costs and therefore will need to be paid by the employer.

3.12 Is the concept of *force majeure* or frustration known in your jurisdiction? What remedy does this give the affected party? Is it usual/possible to argue successfully that a contract which has become uneconomic is grounds for a claim for *force majeure*?

Dutch law recognises “*force majeure*” (“*overmacht*”). In terms of provisions specific to a construction contract, such events initially give rise to a claim for an extension of time and cost compensation (see the answer to question 3.4). In cases in which performance of the contract is impossible due to *force majeure*, the affected party/parties are in fact released from its/their obligation to render performance.

The fact that a contract has become uneconomic does, in general, not qualify as *force majeure*. However, (the cause of) such a fact could possibly qualify as an unforeseen circumstance or error (on both sides) with regard to the facts, which could give rise to nullification or amendment of the contract.

3.13 Are parties, who are not parties to the contract, entitled to claim the benefit of any contractual right which is made for their benefit? E.g. is the second or subsequent owner of a building able to claim against the contractor pursuant to the original construction contracts in relation to defects in the building?

In general, the benefit of a contractual right can only be claimed by a party to the contract, unless specifically agreed upon otherwise. If such a specific arrangement is not included in the contract (e.g. with regard to warranties), third parties will only have extra-contractual claims, such as a claim on the basis of tort or a violation of specific legal rights.

3.14 On construction and engineering projects in your jurisdiction, how common is the use of direct agreements or collateral warranties (i.e. agreements between the contractor and parties other than the employer with an interest in the project, e.g. funders, other stakeholders, and forward purchasers)?

In the Netherlands, direct agreements and/or collateral warranties are common in larger, more complex construction projects in which there are, for example, third parties involved as funders and/or when the employer is a developer looking to sell the works after completion.

3.15 Can one party (P1) to a construction contract, who owes money to the other (P2), set off against the sums due to P2 the sums P2 owes to P1? Are there any limits on the rights of set-off?

Set-off is possible (article 6:127 *et seq.* DCC), provided that the claim to which P1 sets off (P1's claim on P2) is due. The right to set-off is often excluded in general terms and conditions.

3.16 Do parties to construction contracts owe a duty of care to each other either in contract or under any other legal doctrine? If the duty of care is extra-contractual, can such duty exist concurrently with any contractual obligations and liabilities?

The parties to a construction contract will normally owe a duty of care in both tort and contract. For example, the contractor has an obligation to deliver good and decent work, exercise reasonable care and skill and to prevent as much as possible nuisance and damage to persons, goods or the environment.

Furthermore, it follows from the principle of reasonableness and fairness that parties to a contract have to take into account, and adapt their behaviour to, each other's interests. This applies even during the negotiating stage of a contract and with regard to all aspects of (the execution of) the contract. This duty exists concurrently with any (explicit) contractual obligations and liabilities.

3.17 Where the terms of a construction contract are ambiguous, are there rules which will settle how that ambiguity is interpreted?

Under Dutch law, there are two general standards used to interpret contracts. According to the "Haviltex standard", it is not the text of the contract that is decisive, but the meaning that the parties could have reasonably attached to the provisions of the contract in the specific circumstances at hand and what they could reasonably have expected. In the "CAO standard", the

specific wording of the contractual provision is, in principle, not open for interpretation. This does not mean that the parties' intentions are irrelevant to the interpretation of contracts governed by the CAO standard, but that these intentions are only relevant to the extent that third parties could objectively have known about them. The CAO standard not only applies to collective bargaining agreements but, in general, to all contracts which are not the result of negotiations between the contracting parties, e.g. construction contracts which are the result of a public procurement procedure.

3.18 Are there any terms which, if included in a construction contract, would be unenforceable?

Terms that, by their content or necessary implications, violate public morality, public order or a statutory provision of mandatory law are null and void, or voidable in case the statutory provision merely intends to protect one of the parties (article 3:40 DCC). Furthermore, it follows from article 6:248 DCC that any term which, under the given circumstances, would be unacceptable according to the standards of reasonableness and fairness, is unenforceable. The latter is, however, a high threshold which is – at least for construction contracts between professional parties – not often met.

3.19 Where the construction contract involves an element of design and/or the contract is one for design only, are the designer's obligations absolute or are there limits on the extent of his liability? In particular, does the designer have to give an absolute guarantee in respect of his work?

The extent to which the designer is responsible and liable for the design depends on the exact scope and conditions of the contract. In general, the designer must perform its assignment in a proper and careful manner and conduct his services to the best of his knowledge and capacity. Therefore, typically the designer does not have absolute obligations and does not have to give an absolute guarantee.

Under the most common standard form for design contracts, the New Rules 2011, the designer's liability is limited to direct damages and, at the choice of the parties, to a sum equal to the value of the design contract, with a maximum of €1,000,000, or a sum equal to three times the value of the design contract, with a maximum of €2,500,000.

3.20 Does the concept of decennial liability apply in your jurisdiction? If so, what is the nature of such liability and what is the scope of its application?

Not in general. However, the UAC 2012 and the UAC-IC 2005 provide for a 10-year liability of the contractor for defects after completion in case the works have collapsed completely or partially, or threaten to collapse, or have come to be unfit or threaten to be unfit for the purpose for which they were intended.

4 Dispute Resolution

4.1 How are construction disputes generally resolved?

Most construction disputes are resolved in out-of-court settlements between the parties themselves. When parties do submit their disputes for dispute resolution, the choice is mainly between arbitration and litigation. Because of its in-depth knowledge of construction and the construction industry, many parties choose

arbitration by the arbitration board for the building industry (“*Raad van Arbitrage voor de Bouw*”, hereinafter: “RvA”).

4.2 Do you have adjudication processes in your jurisdiction (whether statutory or otherwise) or any other forms of interim dispute resolution (e.g. a dispute review board)? If so, please describe the general procedures.

In case a regular court is competent to hear a dispute, parties will be able to initiate regular substantive proceedings (“*bodemprocedure*”) or interim relief proceedings (“*kort geding*”). Some arbitral tribunals, like the RvA, will similarly also allow similar interim relief proceedings next to their regular proceedings. The RvA also provides ‘Fast-Track Binding Advice Proceedings’ and will, on request, determine the condition or quality of a work area, work, auxiliary work or any part thereof.

4.3 Do the construction contracts in your jurisdiction commonly have arbitration clauses? If so, please explain how, in general terms, arbitration works in your jurisdiction.

The Netherlands has multiple arbitral tribunals that are equipped to hear construction disputes. The most prominent amongst them are the RvA, an arbitral tribunal specialised in construction disputes, and the Netherlands Arbitration Institute (“NAI”). In particular, the awards of the RvA are considered highly authoritative in the field of Dutch construction law. Most construction contracts will therefore designate the RvA as the competent body to rule on their disputes.

Arbitration at the RvA, and other similar tribunals, is similar to court proceedings, with (multiple) written and oral rounds taking place and with the possibility of appeal. Typically, the tribunal will consist of three arbitrators, of whom one will be a lawyer and the other two will have relevant technical expertise. As part of the hearing, which will in general take one full day, arbitrators will visit the construction site concerned, together with the parties, and examine the work if relevant.

4.4 Where the contract provides for international arbitration, do your jurisdiction’s courts recognise and enforce international arbitration awards? Please advise of any obstacles (legal or practical) to enforcement.

The Netherlands is a party to the New York Convention 1958. Foreign arbitral awards can be recognised and enforced on the basis of this or another treaty (article 1075 Dutch Code of Civil Procedure (“DCCP”). Foreign arbitral awards of countries that are not party to any relevant treaty can, under certain conditions, still be recognised and enforced on the basis of article 1076 DCCP.

Courts can refuse recognition and enforcement on specific grounds set out in the New York Convention and the aforementioned articles of the DCC. In most cases, however, foreign arbitral awards will be recognised and enforced in the Netherlands without much difficulty.

4.5 Where a contract provides for court proceedings in your jurisdiction, please outline the process adopted, any rights of appeal and a general assessment of how long proceedings are likely to take to reduce: (a) a decision by the court of first jurisdiction; and (b) a decision by the final court of appeal.

Generally, civil court proceedings in first instance will start with a writ of summons by the plaintiff, summoning the respondent

to court. After the respondent has notified the court of its participation, the respondent will, in principle, have six weeks to submit a statement of defence. After this first written round, the judge will either plan an oral hearing or order a second round of written statements. After the oral and written arguments, the judge will decide on further continuation of the proceedings, e.g. by hearing witnesses or an order to produce evidence, or hand down a judgment. How long it will take for the court of first instance to produce its final decision will depend on the complexity of the case, the procedural decisions of the court and parties’ adopted course of action during the proceedings. In general, proceedings in first instance will take at least one year.

Parties will have three months after the day of the judgment in first instance to file an appeal. Similarly, the appeal procedure will consist of at least one written round and will include the possibility of an oral hearing. After a judgment of the court of appeal, parties will in some cases also be able to file an appeal in cassation at the Dutch Supreme Court. Again, the duration of such appeal procedures will to a great extent depend on the specifics of the case and the course of the proceedings.

Interim relief proceedings also start with a writ of summons. The writ will state the date the respondent will actually need to appear in court for a court hearing, without the need of a prior written statement of defence. After the court hearing, in which both parties will have been granted the opportunity to plead their case, the judge in preliminary relief proceedings will hand down a judgment, generally two weeks after the date of the court hearing. This judgment is also open to appeal and, after a judgment of the appellate court, possibly cassation.

4.6 Where the contract provides for court proceedings in a foreign country, will the judgment of that foreign court be upheld and enforced in your jurisdiction? If the answer depends on the foreign country in question, are there any foreign countries in respect of which enforcement is more straightforward (whether as a result of international treaties or otherwise)?

The DCCP makes a distinction between foreign judgments from countries that have treaties with the Netherlands facilitating the recognition and enforcement of judgments, and judgments from countries that do not have such treaties with the Netherlands.

Disputes ruled upon in countries without a relevant treaty with the Netherlands will have to be resubmitted to the Dutch courts through the normal procedure. The Dutch judge will, in such a procedure, take note of the fact that the dispute has been adjudicated abroad and will decide, mainly on the basis of the quality of the foreign judgment and court proceedings, whether there is a need to reassess the merits of the case or not. Judgments of countries that have a relevant treaty with the Netherlands can generally be enforced by receiving an exequatur of a Dutch court, which will only entail a limited judicial review.

Judgments from courts of EU Member States can be enforced through the “Brussels regime”, which aims to remove obstacles for the inter-union recognition and enforcement of judgments from EU Member States. The Brussels I-*bis* Regulation allows some EU judgments in civil and commercial matters to be enforced without the need for judicial involvement of the Dutch courts altogether.



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1 Making Construction Projects

1.1 What are the standard types of construction contract in your jurisdiction? Do you have: (i) any contracts which place both design and construction obligations upon contractors; (ii) any forms of design-only contract; and/or (iii) any arrangement known as management contracting, with one main managing contractor and with the construction work done by a series of package contractors? (NB For ease of reference throughout the chapter, we refer to “construction contracts” as an abbreviation for construction and engineering contracts.)

The most common standard forms of construction contract in Nigeria are: the Joint Contract Tribunal (JCT) standard form of contract (without quantities), 2005 Edition; the standard form of building contract in Nigeria, 1990 (SFBCN); the International Federation of Consulting Engineers Contract (FIDIC), otherwise known as “The FIDIC conditions of contract for construction for building and engineering works designed by the employer, 1999 Edition”; the general conditions of contract for the procurement of works, 2011 (the GCC); and the Federal Ministry of Works standard conditions of contract (Road works), 1999 Edition (FMOWC). The use of standard form contracts in Nigeria has been found to be convenient, time-saving and cost-effective in the construction industry.

However, the forms may be amended to suit the requirements of some types of project, if so required. In fact, the standard form contracts are mostly used by public sector entities, but not necessarily by private sector entities.

Yes, we have contracts which place both design and construction obligations upon contractors in Nigeria. The JCT Design & Build Contract, 2005 places the obligations for design and construction on contractors, especially in engineering and construction contracts.

We also have design-only contracts. Any of the standard form construction contracts can be adopted to conclude a design-only contract which may operate under the Special Conditions of Contract (SCC), depending on the requirements of the particular construction project in Nigeria.

Yes, management contracting is a well-accepted arrangement in Nigeria’s construction industry.

1.2 How prevalent is collaborative contracting (e.g. alliance contracting and partnering) in your jurisdiction? To the extent applicable, what forms of collaborative contracts are commonly used?

Collaborative contracting is prevalent in Nigeria. It is an agreement

between two or more establishments that are desirous of coming together to undertake construction work.

The forms of collaborative contracts that are commonly used are: Joint Venture Agreements; Partnership Agreements; and Merger Agreements.

1.3 What industry standard forms of construction contract are most commonly used in your jurisdiction?

In Nigeria, the standard forms of construction contract commonly used in the construction industry include:

- The FIDIC Forms.
- The SFBCN, 1990.
- The GCC, 2011.
- The JCT standard form of contract, 2005.
- The Federal Ministry of Works Contract (variant of the JCT).

1.4 What (if any) legal requirements are there to create a legally binding contract (e.g. in common law jurisdictions, offer, acceptance, consideration and intention to create legal relations are usually required)? Are there any mandatory law requirements which need to be reflected in a construction contract (e.g. provision for adjudication or any need for the contract to be evidenced in writing)?

Nigeria is a common law country. The legal requirements for the creation of a legally binding contract in Nigeria are offer, acceptance, consideration, intention to create legal relations and legal capacity.

Contracts generally do not require any formalities and for this reason there are no mandatory law requirements which need to be reflected in a construction contract. However, where the construction contract has to do with building over landed property, then such construction contract must be in writing, having regard to section 4 of the Statute of Frauds, 1677 and section 5 of the Law Reform (Contracts) Act (No. 64), 1961, which require contracts involving lease of land or any form of interest in land to be in writing.

In Nigeria, construction contracts are always in writing because there is a need to have the terms and conditions of the contract clearly spelt out. This is due to the huge capital outlay of the project and the need to avoid controversies thereon.

Furthermore, construction contracts in Nigeria always contain a provision for adjudication or arbitration. The inclusion of an adjudication or arbitration clause in a construction contract makes it mandatory for the contract to be in writing as envisaged by the Arbitration and Conciliation Act, Cap. A18, LFN, 2004.

1.5 In your jurisdiction please identify whether there is a concept of what is known as a “letter of intent”, in which an employer can give either a legally binding or non-legally binding indication of willingness either to enter into a contract later or to commit itself to meet certain costs to be incurred by the contractor whether or not a full contract is ever concluded.

Yes, there is a concept of what is known as a “letter of intent” in Nigeria. Whether or not an employer can, through a letter of intent, give a legally binding indication of willingness to either enter into a contract later or to commit itself to meet certain costs to be incurred by a contractor depends on whether or not the letter of intent does not contain a phrase such as “provisional offer”, “without prejudice” and so on, and has been accepted and/or acted upon by the contractor. Where a letter of intent does not contain such a phrase and has been accepted and/or acted upon by the contractor, such a letter will create a binding contract. However, where such letter of intent contains a phrase (such as “provisional offer” or “without prejudice”) which suggests that there is no binding obligation, any party who acted on the same will be incapable of enforcing the provision of the letter. The use of the aforementioned phrases, “provisional offer” or “without prejudice”, suggests that there is no intention to create legal relations.

1.6 Are there any statutory or standard types of insurance which it would be commonplace or compulsory to have in place when carrying out construction work? For example, is there employer’s liability insurance for contractors in respect of death and personal injury, or is there a requirement for the contractor to have contractors’ all-risk insurance?

There is no statutorily required type of insurance specific to the construction industry. However, section 64 (1) of the Insurance Act, Cap. I 17, LFN, 2010 provides for the insurance of a building under construction. The section provides that: “No person shall cause to be constructed any building of more than two floors without insuring with a registered insurer his liability in respect of construction risks caused by his negligence or the negligence of his servants, agents or consultants which may result in bodily injury or loss of life to or damage to property of any workman on the site or of any member of the public.”

Also, from the provisions of section 65 (1) of the Insurance Act, it is mandatory to insure (with a registered insurer) every public building against the hazards of collapse, fire, earthquake, storm and flood.

“Public building”, from section 65 (2) of the Insurance Act, includes a tenement house, hostel, a building occupied by a tenant, lodger or licensee and any building to which members of the public have ingress and egress for the purpose of obtaining education or medical services, or for the purpose of recreation or transaction of business.

Most standard form construction contracts prescribe insurance cover in the names of both the employer and the contractor. The following are types of insurance commonly required in construction contracts:

- All-risk insurance/loss insurance.
- Public liability insurance.
- Professional indemnity insurance (on a “claims made” basis for professional negligence).
- Latent defect insurance.

1.7 Are there any statutory requirements in relation to construction contracts in terms of: (a) labour (i.e. the legal status of those working on site as employees or as self-employed sub-contractors); (b) tax (payment of income tax of employees); and/or (c) health and safety?

The following statutory requirements exist in relation to construction contracts:

- (a) There are quite a number of pieces of labour legislation that employers and contractors must comply with. These include the Labour Act, 2004, which regulates all aspects of employment in Nigeria, such as terms of employment, wages, classes of workers, probationary periods, redundancy, etc., the Employees Compensation Act, 2010 (ECA), and the Labour Safety, Health, and Welfare Bill, 2012 (LSHWB). The President is yet to give his assent to the LSHWB. When he does so and the LSHWB is signed into law, it shall repeal the extant Factory Act, 2009, and only then will safety and health issues, with respect to construction activities, be adequately covered.
- (b) Employers and employees are required to register for a monthly co-contributory pensions scheme with the Nigerian Social Insurance Trust Fund Scheme (NSITF). Such funds are further remitted to the Pensions Fund Administrator (PFA) of choice for the benefit of the employee at its maturity. Income received as wages are tax-deductible from source by employers under the pay-as-you-earn (PAYE) scheme and are remitted to the State Inland Revenue Service (IRS). Employers and/or contractors, as incorporated companies, pay Company Taxes to the Federal Inland Revenue Service (FIRS). There are other taxes, which include education tax, etc., which may be payable under construction contracts in Nigeria.
- (c) There is no construction industry-specific legislation on health and safety requirements in Nigeria. However, the ECA, 2010 makes provision for compensation of the employee in case of death, injury, disease or disability which may arise in the course of employment. The Factories Act (FA), 2004, does not cover construction sites in its definition of “Factory”. This means, therefore, that the provisions for both safety and health of workers in the said Act exclude employees under construction contracts. However, section 57 of the FA empowers the Minister of Labour and Productivity to make a regulation which will extend the provisions of the FA on safety and health to works and engineering construction sites. It is expected that, when the LSHWB, 2012, is signed into law by the President, safety and health considerations as they relate to construction activities will be covered adequately.

1.8 Is the employer legally permitted to retain part of the purchase price for the works as a retention to be released either in whole or in part when: (a) the works are substantially complete; and/or (b) any agreed defects liability period is complete?

Yes, if that is the agreement of the parties. It is also common for construction contracts to contain a Retention Bond (or Guarantee) for the contractor, in the place of cash, which the employer ought to have retained, prior to full completion of the contract.

1.9 Is it permissible/common for there to be performance bonds (provided by banks and others) to guarantee the contractor's performance? Are there any restrictions on the nature of such bonds? Are there any grounds on which a call on such bonds may be restrained (e.g. by interim injunction); and, if so, how often is such relief generally granted in your jurisdiction? Would such bonds typically provide for payment on demand (without pre-condition) or only upon default of the contractor?

It is common practice in the construction industry for contractors to take out performance Bonds/Guarantees for the benefit of the employer as security for the performance of their obligations under the contract. Under some standard forms of construction contract, like the GCC and the FIDIC contracts, the employer may terminate the contract and also institute an action against the contractor for failing to take out performance bonds. There are no restrictions on the nature of such bonds, but the nature of such is usually determined by the obligations they create.

A call on such bonds may be restrained if there is evidence before the court that the performance bond no longer subsists or that the guarantor had been discharged.

A call on such bonds may also be restrained if the guarantor successfully pleads the doctrine of *non est factum* – meaning that the performance bond was not the deed of the guarantor or never emanated from the latter.

Such relief is most unlikely to be granted on an *ex parte* application. The court would prefer to have the employer put on notice.

If there is a Motion on Notice before the court for such relief, the court would most likely grant the same pending the determination of the substantive suit. However, such reliefs are usually refused by the court after the hearing of the substantive suit, especially if there is no merit in the guarantor's case, which is usually the case.

Performance bonds typically provide for payment only upon default of the contractor.

1.10 Is it permissible/common for there to be company guarantees provided to guarantee the performance of subsidiary companies? Are there any restrictions on the nature of such guarantees?

Yes. There are no restrictions on the nature of such guarantees. The employer is at liberty to accept or refuse guarantees from the contractors' parent company or companies.

1.11 Is it possible and/or usual for contractors to have retention of title rights in relation to goods and supplies used in the works? Is it permissible for contractors to claim that, until they have been paid, they retain title and the right to remove goods and materials supplied from the site?

No. Nigerian law frowns on self-help or lawlessness in any form. It will amount to self-help if the contractors decide to retain title and right to remove goods and materials supplied from the site until they have been paid. However, if the employer and the contractors, from the construction contract, agree otherwise, the court will have no option than to give weight to their intention.

2 Supervising Construction Contracts

2.1 Is it common for construction contracts to be supervised on behalf of the employer by a third party (e.g. an engineer)? Does any such third party have a duty to act impartially between the contractor and the employer? If so, what is the nature of such duty (e.g. is it absolute or qualified)? What (if any) recourse does a party to a construction contract have in the event that the third party breaches such duty?

Construction contracts usually contain provisions for the employment of a third party as the construction manager, who is an agent of the employer. He also performs quasi-judicial decision-making functions and supervises the works. Such construction manager is bound to act impartially. In directing relations between the employer and the contractor, the construction manager's duty as an agent of the employer is limited by the terms of the contract and he must act independently and impartially, when communicating with both of them. However, except where the provisions of the contract place limitations on the powers of the construction manager, the duty of the construction manager is absolute.

A party to a construction contract who is aggrieved with the conduct of the third party is at liberty to resort to court in the event that the third party breaches his duty to act impartially.

2.2 Are employers free to provide in the contract that they will pay the contractor when they, the employer, have themselves been paid; i.e. can the employer include in the contract what is known as a "pay when paid" clause?

A "pay when paid clause" is unusual in construction contracts, especially in Nigeria. However, parties have freedom of contract and there is nothing in law which stops them from introducing this clause to their contract if both parties agree that the clause should form part of the terms of their contract.

2.3 Are the parties free to agree in advance a fixed sum (known as liquidated damages) which will be paid by the contractor to the employer in the event of particular breaches, e.g. liquidated damages for late completion? If such arrangements are permitted, are there any restrictions on what can be agreed? E.g. does the sum to be paid have to be a genuine pre-estimate of loss, or can the contractor be bound to pay a sum which is wholly unrelated to the amount of financial loss likely to be suffered by the employer? Will the courts in your jurisdiction ever look to revise an agreed rate of liquidated damages; and, if so, in what circumstances?

Yes. Parties are free to make a provision for loss occasioned by the breach of the construction contract. Where the provision is a genuine attempt to pre-estimate the loss likely to follow from the breach, the clause will be a liquidated damages clause and the employer will be able to recover that sum irrespective of his actual loss. The employer will be bound by that amount whether or not the amount is smaller than the actual loss suffered by him.

Yes, there are restrictions on what can be agreed. The sum to be paid has to be a genuine pre-estimate of the loss occasioned by the contractor.

Yes, the court has unfettered discretion to re-open the construction contract and revise the agreed rate of liquidated damages where the sum agreed upon is a penal sum, that is, an amount designed to deter the contractor from breaking the construction contract or an amount that would give the employer an unmeritorious windfall. The court can also re-open the construction contract if it finds the same to be extortionate. A contract will be extortionate where, for example, the agreement is harsh and unconscionable or where there is a provision for a rate of interest which is excessive. The court may strike out the clause as penal and the employer, in this circumstance, will be left with his claims for damages at large.

3 Common Issues on Construction Contracts

3.1 Is the employer entitled to vary the works to be performed under the contract? Is there any limit on that right?

The terms of the construction contract, including the works to be done under the contract and the rights and obligations of the parties to the contract, are stated in the construction contract. The contract itself is the document to be considered in determining whether or not the employer is entitled to vary the works to be done. Also, whether or not there is a limit on that right is a fact that is to be gathered from the contract.

If the contract is silent on this matter, then any variation that would fundamentally change the works to be done would automatically constitute a new contract for which a new contract price would be agreed.

3.2 Can work be omitted from the contract? If it is omitted, can the employer carry out the omitted work himself or procure a third party to perform it?

Any item of work which the employer chose to omit whilst drawing the contract necessarily cannot be part of the contract, and the right to do the work himself or award it to a third party is also not fettered by any external instrument or statute. It is uncommon for contracts to stipulate that the employer may omit work for the purpose of awarding it to another party.

3.3 Are there terms which will/can be implied into a construction contract (e.g. a fitness for purpose obligation, or duty to act in good faith)?

The various rights and obligations of parties to a contract are often provided in the specific contract. In Nigeria, implied terms are read into the contract by either the conduct of the parties, or operations of law, or by the custom or usage of the trade to which the transaction relates. Implied terms often flow or read into the express terms of the contract. However, any term which would contradict the express terms and character of the contract would not be implied into the contract.

3.4 If the contractor is delayed by two concurrent events, one the fault of the contractor and one the fault or risk of his employer, is the contractor entitled to: (a) an extension of time; and/or (b) the costs arising from that concurrent delay?

Where the cause of a delay is concurrent, in that both the employer's delaying event and the contractor's delaying event

occurred simultaneously, the contractor will be entitled to an extension of time in the absence of any contrary provision in the construction contract.

However, where the fault of the employer is the dominant cause of the delay, the contractor, in the absence of any contrary intention of parties, may be entitled to costs occasioned by the delay.

3.5 Is there a time limit beyond which the parties to a construction contract may no longer bring claims against each other? How long is that period and when does time start to run?

Yes, there is a limit beyond which the parties to a construction contract may no longer bring claims against each other.

The period is six years and time begins to count from the date the cause of action arose (section 7 of the Limitation Act, Cap. 522, LFN (Abuja), 1990). However, the general rule of limitation of action admits some exceptions, one of which is the written acknowledgment or part-payment of debt. The principle of acknowledgment or part-payment is founded on the theory that acknowledgment or part-payment postpones time and establishes a fresh contractual relationship so that a cause of action then starts to run from the date of the fresh contractual relationship (*L.T Tbadani & Anor. vs. National Bank of Nigeria Ltd.* 1972 LPELR SC. 63/1969).

Furthermore, the Supreme Court of Nigeria has held that where an action is instituted by a party to a construction contract within time but at the wrong court, the time spent in the wrong court would not be counted when considering the issue of the limitation period (*Sifax Nigeria Limited & 4 ors. vs. Migfo Nigeria Ltd & Anor* (2018) 9 NWLR (Pt. 1623) 138 at 185, para. E).

3.6 Which party usually bears the risk of unforeseen ground conditions under construction contracts in your jurisdiction?

This can be determined in the contract. But generally in law, save for any term to the contrary, the contractor bears the risk of unforeseen ground conditions. It is commonly expected that the construction contract will state who bears what risk. Quite often, the procurement methods adopted help in apportioning risks appropriately, while being mindful of the principle that risk should be allocated to the party most able to bear it.

3.7 Which party usually bears the risk of a change in law affecting the completion of the works under construction contracts in your jurisdiction?

The contract, of course, will specifically indicate which party bears the risk of a change in law affecting completion. However, it is an implied term in the construction contract that the contractor must adhere to and comply with extant laws and regulations applicable to its operation. In the absence of an express provision in the contract specifying who bears what risk, each party in the contract will be responsible for complying with the obligations of the law pertaining to it.

3.8 Which party usually owns the intellectual property in relation to the design and operation of the property?

The employer pays for and obtains ownership of all intellectual property severally developed by the architect/designer or contractor for the execution of the project, provided that the contract did not specify otherwise.

3.9 Is the contractor ever entitled to suspend works?

A contractor cannot, without appropriate notice to the architect/engineer, suspend work, even where the employer has failed to pay in accordance with the contract's terms.

The suspension of work by the contractor without due regard to the contractual provisions may make it liable for breach of contract or delay. The time and manner in which a contractor may suspend work is usually governed by the relevant provisions and terms of the contract.

3.10 Are there any grounds which automatically or usually entitle a party to terminate the contract? Are there any legal requirements as to how the terminating party's grounds for termination must be set out (e.g. in a termination notice)?

Yes. If there is a breach of the fundamental terms of the contract, the innocent party is not only entitled to terminate the contract but also has the right to seek damages for breach of contract.

The contract may also stipulate the grounds upon which the innocent party may terminate the contract. Such grounds include grounds of fraud, misrepresentation, mistake, etc.

3.11 Do construction contracts in your jurisdiction commonly provide that the employer can terminate at any time and for any reason? If so, would an employer exercising that right need to pay the contractor's profit on the part of the works that remains unperformed as at termination?

Construction contracts in Nigeria do not commonly provide that the employer can terminate at any time and for any reason.

However, where an employer terminates a construction contract before the completion of work, the employer may be sued by the contractor for breach of contract and may be ordered to pay both special and general damages to the contractor. The employer cannot, however, be made to pay contractor's profit on the part of the works that remains unperformed as at termination.

3.12 Is the concept of *force majeure* or frustration known in your jurisdiction? What remedy does this give the affected party? Is it usual/possible to argue successfully that a contract which has become uneconomic is grounds for a claim for *force majeure*?

The concept of "*force majeure*" or frustration of contract is well recognised under Nigerian law and such *force majeure* events include natural disasters (earthquakes, floods, tornados, hurricanes), war, labour strikes, pandemics and so on, for which contracting parties cannot be held accountable or responsible. A *force majeure* event is an event which may take place in the course of a contract which is capable of hampering the performance of the contract. A *force majeure* clause is included in a contract to excuse the breach of the same as a result of acts that are independent of the will of the parties to the contract.

Force majeure also entitles the party relying on it to extend performance of the contract. A contract which has become uneconomic cannot sufficiently ground a claim of *force majeure* in order to be excused from the obligations in the contract.

3.13 Are parties, who are not parties to the contract, entitled to claim the benefit of any contractual right which is made for their benefit? E.g. is the second or subsequent owner of a building able to claim against the contractor pursuant to the original construction contracts in relation to defects in the building?

Under the common law doctrine of privity of contract, which is applicable in Nigeria, a contract does not confer any benefit or impose obligations on non-parties to the contract. However, there are exceptions to the general rule of privity of contract doctrine whereby, under a construction contract, a third party could benefit under the contract. A collateral warranty provides for an extra-contractual facility, which gives rights to a third party under the contract. In other words, a subsequent owner of a building can claim against the contractor pursuant to the original construction contract in relation to defects in the building, if any.

3.14 On construction and engineering projects in your jurisdiction, how common is the use of direct agreements or collateral warranties (i.e. agreements between the contractor and parties other than the employer with an interest in the project, e.g. funders, other stakeholders, and forward purchasers)?

The use of direct agreements or collateral warranties (i.e. agreements between the contractor and parties other than the employer) is very common in construction and engineering projects in Nigeria.

3.15 Can one party (P1) to a construction contract, who owes money to the other (P2), set off against the sums due to P2 the sums P2 owes to P1? Are there any limits on the rights of set-off?

Set-off is a term well recognised under Nigerian law. Where two parties are both indebted to each other, one debt can set off the other. However, both debts claimed by the two parties must be in the form of a liquidated money demand. There is no set-off right against future debt or debt which is still contested.

3.16 Do parties to construction contracts owe a duty of care to each other either in contract or under any other legal doctrine? If the duty of care is extra-contractual, can such duty exist concurrently with any contractual obligations and liabilities?

Parties to construction contracts owe a duty of care to each other both in contract and in tort and such duty of care, which is extra-contractual, can exist concurrently with any contractual obligations and liabilities.

3.17 Where the terms of a construction contract are ambiguous, are there rules which will settle how that ambiguity is interpreted?

Yes. The rules of interpretation include the Literal Rule, Golden Rule, Mischief Rule and the *Ejusdem Generis* Rule. These rules, popularly known as the Rules of Interpretation, are to aid the courts in resolving the ambiguity in the provisions of construction contracts in order to know the intendment of parties to construction contracts.

3.18 Are there any terms which, if included in a construction contract, would be unenforceable?

Yes. The Nigerian courts will not enforce contracts whose terms would produce any unlawful purpose or will be illegal and/or contrary to public policy.

3.19 Where the construction contract involves an element of design and/or the contract is one for design only, are the designer's obligations absolute or are there limits on the extent of his liability? In particular, does the designer have to give an absolute guarantee in respect of his work?

To properly situate the obligations or liabilities of the designer in a construction contract, the terms of the contract must be considered. In a typical design and build contract, the design is undertaken by a professional (an architect/engineer) and it is implied in a contract that such a professional will deploy the utmost care, skill and expertise in carrying out his obligations under the contract. In relation to this, a designer may be found to owe a "fit for purpose" obligation. However, onerous responsibilities in respect of the construction are placed on the contractor, who impliedly must be found to have undertaken to provide works that are fit for purpose, and in that regard the contractor's obligations are quite absolute. This is often not the case for the designer. The designer may only be liable for negligence (where the design is found to be defective), except where there is a collateral agreement with the contractor wherein the designer has given an absolute guaranty in respect of his work.

3.20 Does the concept of decennial liability apply in your jurisdiction? If so, what is the nature of such liability and what is the scope of its application?

Decennial liability is a legal liability insurance taken out by builders to cover the costs associated with the defects that may compromise the integrity of their structures or make them unsuitable for their intended purposes.

Although, in Nigeria, no statute has provided for the concept of decennial liability, parties to a construction contract are at liberty to introduce the concept to their contract and make provisions that will cover costs associated with the potential collapse of the building after completion thereof.

4 Dispute Resolution

4.1 How are construction disputes generally resolved?

Construction disputes are generally resolved through consensual methods such as mediation, conciliation or arbitration. Where these methods fail, resort to litigation becomes the last option for parties.

The mutual demand for speed, cost-effectiveness, preservation of relationships and maintenance of privacy needed in the resolution of construction contract disputes are the factors that determine the dispute resolution method to be adopted by parties. Construction contracts always contain the preferred or chosen method for dispute resolution, and the method, as well as other terms of the contract, is binding on parties.

4.2 Do you have adjudication processes in your jurisdiction (whether statutory or otherwise) or any other forms of interim dispute resolution (e.g. a dispute review board)? If so, please describe the general procedures.

Yes. Adjudication processes are available for the resolution of construction contract disputes in Nigeria, but they are sparingly deployed. The adjudication method of choice is contractually included in the standard form of construction contract even though there is no statute governing adjudication in Nigeria. The appointment of the adjudicators is made jointly by the employer and the contractor and named in the Special Conditions of Contract (SCC). Since there is no legislation governing adjudication in Nigeria, all incidences of adjudication operate contractually in accordance with the relevant forms of construction contract, e.g. the GCC Form. The procedures are therefore as provided in the said agreements.

4.3 Do the construction contracts in your jurisdiction commonly have arbitration clauses? If so, please explain how, in general terms, arbitration works in your jurisdiction.

Yes. Arbitration as a method of dispute resolution is the most preferred mechanism for the resolution of disputes in the construction industry in Nigeria. Arbitral proceedings are initiated in accordance with the Arbitration and Conciliation Act, Cap. A18, LFN, 2004, and the rules made pursuant thereto. The outfits that render arbitration services include the multi-door courthouses within the premises of the High Court of the different States of the Federation, the International Centre for Arbitration and Mediation in Abuja and the Lagos Regional Centre for International Commercial Arbitration. Construction contracts normally provide for: the processes for referrals to arbitration; the number of arbitrators; the qualification that the proposed arbitrator must possess; the appointing authority, if the parties did not agree on who to appoint as the arbitrator(s); and the applicable law that would govern the arbitral proceedings, etc.

Parties are bound by the arbitration clause contained therein, if any. Where the arbitral tribunal comprises more than one arbitrator, any decision of the tribunal, known as the "award", shall, unless otherwise agreed by the parties, be made by a majority of all the members of the tribunal (section 24 (1) of the Arbitration and Conciliation Act).

The court may set aside an arbitral award, if the party making the application furnishes proof that the award contains decisions on matters which are beyond the scope of the submission to arbitration (section 29 (2) of the Act). The court may also set aside the award of an arbitral tribunal where an arbitrator has misconducted himself, or where the arbitral proceedings or award have been improperly procured (section 30 (1) of the Act).

An arbitral award is recognised as binding and is enforceable by the court upon the application of the party relying thereon (section 31 of the Act).

4.4 Where the contract provides for international arbitration, do your jurisdiction's courts recognise and enforce international arbitration awards? Please advise of any obstacles (legal or practical) to enforcement.

Nigeria has domesticated the Convention on the Recognition and Enforcement of Foreign Awards (the New York Convention)

and has ratified the same. Thus, foreign arbitral awards in international commercial disputes are enforceable by the Nigerian courts, except where the awards are from countries that are not privy to the Convention or where public policy considerations will hamper their enforceability.

4.5 Where a contract provides for court proceedings in your jurisdiction, please outline the process adopted, any rights of appeal and a general assessment of how long proceedings are likely to take to reduce: (a) a decision by the court of first jurisdiction; and (b) a decision by the final court of appeal.

Court proceedings in Nigeria are initiated in accordance with the rules of the relevant court.

There are four ways of commencing an action in the Nigerian courts, particularly in the High Court and the Federal High Court. These are by Writ of Summons, by Originating Summons, by Originating Motion or by Application and Petition. Writ of Summons and Originating Summons are the most common ways of commencing an action in the Nigerian courts. An action that is contentious or likely to be contentious is commenced by way of Writ of Summons, while Originating Summons is used for an action that is not contentious or likely to be contentious (Order 2, Rule 1 of the High Court of the Federal Capital Territory (Civil Procedure) Rules, 2018, and Order 5 of the High Court of Lagos State (Civil Procedure) Rules, 2019).

Actions that are not contentious include actions for interpretation of contracts, wills, judgments or documents generally.

Disputes emanating from construction contracts with regard to breaches of contract or declaratory orders for specific performance are, by the rules of the relevant State High Court, instituted in the High Court of the State where the contract ought to have been performed or where the defendant resides or carries on business.

By the Constitution of the Federal Republic of Nigeria, 1999, as amended, any party that is aggrieved by the decision of the High Court or any other courts of co-ordinate jurisdiction, such as the Federal High Court and National Industrial Court, is entitled to appeal against that decision to the Court of Appeal.

An aggrieved party must file its appeal against the said decision within 90 days if the decision is a final decision, and within 14 days if it is an interlocutory decision, or within such longer period the Court of Appeal may allow upon the application of the Appellant for an extension of time. Appeals from the decision of the Court of Appeal go to the Supreme Court which has the final say in any matter brought before it.

Final decisions from the court of first instance may take between one and three years. Summary trial proceedings or proceedings under the undefended list may be concluded in less than 12 months.

Appeals from the Court of Appeal up to the Supreme Court may not take less than 10 years because the Court of Appeal and Supreme Court give priority to cases such as criminal cases, cases involving financial crimes and election petition matters. This is why alternative dispute resolution is strongly recommended for construction contract disputes.

4.6 Where the contract provides for court proceedings in a foreign country, will the judgment of that foreign court be upheld and enforced in your jurisdiction? If the answer depends on the foreign country in question, are there any foreign countries in respect of which enforcement is more straightforward (whether as a result of international treaties or otherwise)?

Yes, especially if the judgment is from a country that will give reciprocal enforcement to the judgments from the Nigerian courts.

By virtue of the combined interpretation of the Foreign Judgment (Reciprocal Enforcement) Act, Cap. F35, LFN, 2004, and the Reciprocal Enforcement of Judgments Ordinance, Cap. 175, LFN, 1958, foreign judgments may be upheld and given effect to in Nigeria if the judgments have been registered in the High Court of the State where the judgments are to be enforced. Foreign judgments are enforceable provided:

- (a) they are judgments of superior courts in the foreign country, which has reciprocal treatment of judgments with Nigeria; and
- (b) they have to do with monetary judgments that are final and conclusive between the parties.

Under the Ordinance, the application for leave to register the said foreign judgment in Nigeria must be brought within 12 months from the date the judgment was delivered in the foreign court. Once registered, it then becomes a judgment of the High Court and can become enforceable via a certificate issued in accordance with the Sheriffs and Civil Process Act, C6, LFN, 2004.

Enforcement is more straightforward in Commonwealth countries like Nigeria because these countries are always ready to give effect to the judgments emanating from the Nigerian courts.



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Abuka & Partners emerged from the restructuring of the law firm popularly known as Abuka, Ajegbo, Ilogu & Nwaogu which was founded in Lagos on 28 March 1979 by the four named partners who had practised individually and separately until that date. Abuka & Partners maintains offices in Lagos and Abuja. The Abuja office was set up in the Federal Capital Territory in 1987, initially with a view to effectively providing the complex and sophisticated legal services required by a major multinational corporate client which has businesses in 109 countries around the world. The firm's areas of practice include Commercial and Corporate Law, International Joint Ventures, Foreign Direct Investments, Immigration Law, Intellectual Property, Equipment Finance and Leasing, Law of Banking and Insurance, Capital and Money Markets, Secured Credit Transactions, Natural Resources Law, Aviation Law and Constitutional Law.



Norway



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1 Making Construction Projects

1.1 What are the standard types of construction contract in your jurisdiction? Do you have: (i) any contracts which place both design and construction obligations upon contractors; (ii) any forms of design-only contract; and/or (iii) any arrangement known as management contracting, with one main managing contractor and with the construction work done by a series of package contractors? (NB For ease of reference throughout the chapter, we refer to “construction contracts” as an abbreviation for construction and engineering contracts.)

There are two main types of construction contract in Norway:

- (i) NS 8405:2008 Norwegian building and civil engineering contracts; and
- (ii) NS 8407:2011 General conditions of contract for design and build contracts.

The above standard contracts have been prepared and unanimously recommended by a committee appointed by Standards Norway, based on a proposal put forward by representatives both from the employer side and the contractor side, and may thus be regarded as “agreed documents”.

NS 8405 has been prepared for use in a contractual relationship in which one party (the contractor) undertakes to carry out building or civil engineering work (including installations, new buildings, maintenance, repairs and alterations) for another party (the employer), and in which most of the drawings, descriptions and calculations are to be provided by the employer. Thus, this standard contract places the design obligations upon the employer and the construction obligations upon the contractor.

NS 8407 has been prepared for use in a contract where one part (the design and build contractor) takes on all or a substantial proportion of the design work in addition to the execution of building or civil engineering work (including installations, new buildings, maintenance, repairs and alterations) for another party (the employer). Thus, this standard contract places both the design and construction obligations upon the contractor.

As to the forms of design-only contracts, the following standard is commonly used: NS 8401:2010 General conditions of contract for design commissions. This standard is intended to regulate contractual relations between commissioning parties and architects, consultant engineers and other professionals in the context of design commissions in the construction and civil engineering sector, including the follow-up of design work during the construction period and warranty period.

Further, we refer to the standard NS 8402:2010 General conditions of contract for consultancy commissions with remuneration based on actual hours spent. This standard is intended to regulate contractual relations between commissioning parties and architects, consultant engineers and other professionals in the context of commissions connected to the construction and civil engineering sector, and is, for example, used for follow-up work during the construction period.

In addition, we refer to the standard NS 8403:2005 General conditions of contract for construction supervision commissions. This standard is intended to regulate contractual relations between commissioning parties and construction supervisors relating to construction supervision in the context of construction and civil engineering works.

Lastly, we refer to the standard NS 8404:2013 General conditions for independent control commissions.

A standard contract for EPCM (engineering, procurement, and construction management services) contracts has not been developed in Norway and EPCM contracts are not widely used within the construction sector.

1.2 How prevalent is collaborative contracting (e.g. alliance contracting and partnering) in your jurisdiction? To the extent applicable, what forms of collaborative contracts are commonly used?

Collaborative contracting or alliance contracting is used in Norway, but there are at present no standard forms for such contracts. The use of collaborative contracting is increasing both onshore and offshore.

1.3 What industry standard forms of construction contract are most commonly used in your jurisdiction?

NS 8405:2008 Norwegian building and civil engineering contracts and NS 8407:2011 General conditions of contract for design and build contracts are most commonly used; see our answer to question 1.1 above for additional details about these standard forms of construction contract.

Within the offshore sector, the Norwegian Fabrication Contract (fabrication/construction obligations upon the contractor) and Norwegian Total Contract (design and construction obligations upon the contractor), both revised and updated in 2015, are commonly used. Some employers also use these standards as the basis for construction, and design and construction, contracts for onshore construction projects.

1.4 What (if any) legal requirements are there to create a legally binding contract (e.g. in common law jurisdictions, offer, acceptance, consideration and intention to create legal relations are usually required)? Are there any mandatory law requirements which need to be reflected in a construction contract (e.g. provision for adjudication or any need for the contract to be evidenced in writing)?

As a starting point and in accordance with the Norwegian Contract Act, a legally binding contract is generally entered into once an offer has been given and such offer is accepted within the time limit for acceptance. In contrast to English contract law, two parties can enter into a binding agreement regardless of whether or not any (mutual) “consideration” is agreed upon.

Pursuant to Norwegian case law, an agreement may be legally binding even if the parties have not entered into a written contract. For instance, an agreement can be legally binding based on one party’s act of *quasi ex contractu* (a certain type of behaviour), or if it can be determined that the parties have agreed on the main terms of the agreement. Furthermore, the contracting parties’ justified expectations may imply that a legally binding contract has been entered into.

Consequently, there are no formal requirements with respect to the validity and enforceability of a contract, i.e. that written contracts, oral contracts and electronic contracts (scans) are binding upon the parties and will be enforceable. In order to enforce an agreement, it would only be necessary to demonstrate on the balance of probabilities that the parties have entered into the agreement in question.

1.5 In your jurisdiction please identify whether there is a concept of what is known as a “letter of intent”, in which an employer can give either a legally binding or non-legally binding indication of willingness either to enter into a contract later or to commit itself to meet certain costs to be incurred by the contractor whether or not a full contract is ever concluded.

Pursuant to Norwegian case law, there is a presumption that a Letter of Intent does not commit the parties to enter into the intended agreement. By entering into a Letter of Intent, the parties are committed to the process of entering into a legally binding contract, not to the contract *per se*. By signing a Letter of Intent, the parties demonstrate that they are serious and committed to act loyally in negotiations towards a final agreement, but it does not involve a legal duty to enter into a binding contract.

However, there is a “point of no return”, and the circumstances may imply that the parties cannot back out of the agreement. It is important to keep in mind that it is the contents of the Letter of Intent that serve as a guideline for the interpretation. It has no consequence that the parties have called the agreement a “Letter of Intent”, as long as the nature of it fulfils the general conditions for a legally binding contract.

1.6 Are there any statutory or standard types of insurance which it would be commonplace or compulsory to have in place when carrying out construction work? For example, is there employer’s liability insurance for contractors in respect of death and personal injury, or is there a requirement for the contractor to have contractors’ all-risk insurance?

According to NS 8407, the contractor shall keep insured materials, design documents and that part of the work which has been performed at any time until delivery/take-over of the

contract object. The employer must be co-insured. Further, the contractor shall procure and maintain liability insurance, which shall cover liability for any damage and economic loss the contractor may cause to the person or possessions of the employer or any third party in connection with the performance of its obligations under the contract.

The parties are, however, free to agree on a different insurance regime.

With regard to large building or civil engineering work contracts, we often see that the employer provides and maintains a “Construction All Risk” (“CAR”) or “Builder’s All Risk” (“BAR”) insurance. On such occasions, the contractor will usually be co-insured.

For the sake of completeness, it should be mentioned that an employer must, according to mandatory labour legislation, provide and maintain workmen’s injury insurance. In addition, employers will always require that the contractor provides and maintains liability insurance and, in the case of design work, often professional liability insurance has to be provided and maintained by the engineer.

1.7 Are there any statutory requirements in relation to construction contracts in terms of: (a) labour (i.e. the legal status of those working on site as employees or as self-employed sub-contractors); (b) tax (payment of income tax of employees); and/or (c) health and safety?

Norwegian authorities have a constant (and increasing) focus on securing equal working conditions, maintaining good health and safety conditions, and determining environment (“HSE”) routines on construction sites in Norway. Many of the large-scale buyers in Norway are public procurers, which have a particular focus on compliance. Both HSE and CSR issues are often to a certain extent regulated in construction contracts. Contractors who are interested in Norwegian construction projects must be prepared to provide documentation for both their proper knowledge about the relevant legislation, and their ability/willingness to implement systems that will ensure that projects are performed in compliance with such legislation.

There are statutory requirements (and collective wage agreements) with respect to, *inter alia*, the following:

- (i) working conditions: includes requirements related to salary, holidays and holiday pay, working hours, insurance and pension, accommodation and other working conditions; and
- (ii) health, safety and environment matters: mainly consisting of requirements relating to safety on construction sites, and the obligation to ensure a safe physical and mental working environment.

The contractor must ensure that the salary and working conditions applicable for the contractor or any sub-contractor personnel are in accordance with the Act of 4 June 1993 no. 58 relating to general application of wage agreements, etc. and regulations appurtenant to the Act. As a minimum, the conditions shall correspond to the wage agreements applicable to the work.

As to HSE, the employer mainly has a controlling function, whereas the contractor is responsible for ensuring that compliance with HSE requirements is an integral part of the work plan. The contractor must present a plan for its HSE work, regular safety inspections must be carried out, and routines and systems for handling lapses and incidents must be established.

With respect to tax, the contractor must submit an RF-1199 form to the Central Office – Foreign Tax Affairs (“COFTA”) concerning information about the contract, contractor and his personnel. Whether an employee must pay tax on earnings

from work which has been performed in Norway depends on several conditions, e.g. the period of time spent in Norway and whether the business may be deemed as conducted or carried out in Norway. In any event, tax agreements between Norway and another state may limit the right to demand payment of income tax related to work performed in Norway.

1.8 Is the employer legally permitted to retain part of the purchase price for the works as a retention to be released either in whole or in part when: (a) the works are substantially complete; and/or (b) any agreed defects liability period is complete?

According to NS 8407, a deduction of 7.5% of the progress payment shall be made by way of retention. The retention shall be invoiced and payable in connection with the final account. In addition, the employer may withhold payment if the employer has legitimate claims against the contractor.

1.9 Is it permissible/common for there to be performance bonds (provided by banks and others) to guarantee the contractor's performance? Are there any restrictions on the nature of such bonds? Are there any grounds on which a call on such bonds may be restrained (e.g. by interim injunction); and, if so, how often is such relief generally granted in your jurisdiction? Would such bonds typically provide for payment on demand (without pre-condition) or only upon default of the contractor?

It is common for the contractor to be required to provide the employer with a performance bond (bank guarantee) to guarantee the correct performance of contractors' obligations under the contract. There are no general restrictions on the nature of such bonds (guarantees), provided that the contract is entered into between professional parties.

In accordance with NS 8407, the contractor shall provide the employer with security for the performance of his contractual obligations during the execution period and the guarantee period. The security during the execution period, including liability for delayed completion, shall amount to 10% of the contract price. Upon take-over/delivery of the work, the security shall be reduced to 3% of the contract price in respect of any guarantee claims for a period of three years. The security shall be provided in the form of an ordinary bank guarantee (not an on-demand guarantee) from a bank, insurance company or other financial institution. However, in construction and supply contracts we often see that an on-demand guarantee is required, i.e. the guarantor cannot invoke any defences and/or counterclaims which otherwise would have been available for the contractor.

As a starting point, it would not be possible to restrain a call on performance bonds by an interim injunction. Consequently, if the guarantor accepts to pay the amount claimed to the employer, the contractor usually has no means to prevent any such payments (and thereby avoid a scenario where the contractor itself must initiate subsequent legal proceedings against the employer). However, if the employer's call on the performance bond must be deemed as "manifestly ill-founded" or "fraudulent", etc., the contractor may succeed in persuading Norwegian courts to grant him an injunction restraining the guarantor from making payment, even though the demand has been made in accordance with the terms of the performance bond. Such grant of injunctions will be challenging to obtain, and the contractor must have clear evidence that the beneficiary knows that the demand for payment is "manifestly ill-founded" or "fraudulent".

1.10 Is it permissible/common for there to be company guarantees provided to guarantee the performance of subsidiary companies? Are there any restrictions on the nature of such guarantees?

It is quite common to require a parent company guarantee in the event the contractor is the subsidiary of another company, often to be issued by the subsidiary's ultimate parent. There are no general restrictions on the nature of such parent company guarantees, provided that the contract is entered into between professional parties.

1.11 Is it possible and/or usual for contractors to have retention of title rights in relation to goods and supplies used in the works? Is it permissible for contractors to claim that, until they have been paid, they retain title and the right to remove goods and materials supplied from the site?

In accordance with NS 8407, the contract work shall become the property of the employer progressively as the work is performed. Materials delivered to the project site and which are to be incorporated into the contract object become the property of the employer upon payment. Materials delivered by the employer shall remain the property of the employer.

The parties may agree that the contractor retain title and the right to remove goods and materials from the site. However, the contractor is in principle not entitled to invoke retention rights towards the employer's creditors with respect to materials, etc., which have been incorporated into the main object.

2 Supervising Construction Contracts

2.1 Is it common for construction contracts to be supervised on behalf of the employer by a third party (e.g. an engineer)? Does any such third party have a duty to act impartially between the contractor and the employer? If so, what is the nature of such duty (e.g. is it absolute or qualified)? What (if any) recourse does a party to a construction contract have in the event that the third party breaches such duty?

Some construction contracts are supervised on behalf of the employer by a third party. Such an engineer or architect would not have a particular duty to act impartially between the contractor and the employer. However, the third party would possibly have some fiduciary duties towards the contractor and may not act in "bad faith" or in a "blameworthy" manner towards the contractor (which may result in liability for damages). The standard NS 8403:2005 General conditions of contract for construction supervision commissions are often used for supervision contracts.

2.2 Are employers free to provide in the contract that they will pay the contractor when they, the employer, have themselves been paid; i.e. can the employer include in the contract what is known as a "pay when paid" clause?

Yes, the parties may agree to include a "pay when paid" clause in the contract. However, it cannot be excluded that a "pay when paid" clause may on some occasions be deemed "highly unreasonable" and consequently set aside or modified by a Norwegian court.

2.3 Are the parties free to agree in advance a fixed sum (known as liquidated damages) which will be paid by the contractor to the employer in the event of particular breaches, e.g. liquidated damages for late completion? If such arrangements are permitted, are there any restrictions on what can be agreed? E.g. does the sum to be paid have to be a genuine pre-estimate of loss, or can the contractor be bound to pay a sum which is wholly unrelated to the amount of financial loss likely to be suffered by the employer? Will the courts in your jurisdiction ever look to revise an agreed rate of liquidated damages; and, if so, in what circumstances?

The parties are free to agree on liquidated damages in the event of particular breaches, including in case of delay, and there are no mandatory requirements or general restrictions with respect to liquidated damages between professional parties. Consequently, the contractor can be bound to pay a sum which is wholly unrelated to the amount of financial loss likely to be suffered by the employer.

Pursuant to the Norwegian Contract Act, Norwegian courts may set aside or revise an agreed rate of liquidated damages if it finds that the total amount payable is “highly unreasonable”, which must be assessed on a case-by-case basis. Such revision is very unlikely with respect to construction contracts between professional parties.

3 Common Issues on Construction Contracts

3.1 Is the employer entitled to vary the works to be performed under the contract? Is there any limit on that right?

In accordance with NS 8407 (and NS 8405), the employer is entitled to vary the works to be done under the contract. A variation to the work must be sufficiently connected to the contract in question and must not be of a materially different nature to the originally agreed work. Unless otherwise agreed, the employer is not entitled to order the contractor to make changes representing an addition to the contract price of more than 15%.

3.2 Can work be omitted from the contract? If it is omitted, can the employer carry out the omitted work himself or procure a third party to perform it?

According to NS 8407, parts of the work can also be omitted from the contract. If it is omitted, it is somewhat uncertain whether the employer may get a third party to perform the work. In our opinion, the employer would in most instances not be entitled to issue a negative variation order (omit work from the contract) if the intention is that the employer wishes to transfer parts of the scope of work to another contractor.

3.3 Are there terms which will/can be implied into a construction contract (e.g. a fitness for purpose obligation, or duty to act in good faith)?

Subject to certain exceptions, the Norwegian background law (both general contract law and construction law) would only apply as a “gap-filler” to the extent legal questions have not been regulated in the contract. Further, in contrast to, for example, English contract law, the judge or arbitrator would

not necessarily be bound “by the four corners” of the contract, and may use the background law in the interpretation of the contract.

In furtherance of the above, there are certain general principles of Norwegian contract law which will apply regardless of the contents of the contract, e.g. a duty to act in good faith and/or in a loyal manner by, to a reasonable degree, taking into account the interests of the other party. However, requirements which are more specific in their nature, e.g. a fitness for purpose obligation, will usually not be implied into the contract without any clear indications that the contractor has assumed such an obligation, in particular if the contract already includes relevant provisions dealing with the matter at issue (e.g. conditions for when the contract work shall be deemed defective).

3.4 If the contractor is delayed by two concurrent events, one the fault of the contractor and one the fault or risk of his employer, is the contractor entitled to: (a) an extension of time; and/or (b) the costs arising from that concurrent delay?

In the case of concurrent delay, the contractor would be entitled to an extension of time equal to the parts of the delay that may be attributed to the fault of the employer, provided that the fault of the employer impacts the “critical path”. If the contractor is delayed as a result of two events/faults occurring in parallel, where one is the fault or risk of the contractor and one is the fault or risk of the employer, the contractor would, as a main rule, not be entitled to an extension of time.

As to the costs incurred by the contractor, the employer would only be liable for increased costs which may be attributed to a fault or risk of the employer. If there are two faults occurring in parallel, and the costs would have occurred regardless of the employer’s fault, the contractor would, as a main rule, not be entitled to the costs occasioned by that concurrent delay.

3.5 Is there a time limit beyond which the parties to a construction contract may no longer bring claims against each other? How long is that period and when does time start to run?

NS 8407 includes certain time limits that the parties must respect. If a party fails to submit a claim within such time limits, then the party loses its claim against the other party.

With regard to variation orders and variation order requests, the standard sets out several strict time limits. The main rule is that the contractor is obliged to submit a variation order request to the employer “without undue delay” after he becomes aware, or ought to have become aware, of the circumstances which form the basis for the variation order request.

Further, if the contractor receives a rejection in response to a variation order request, including a demand for an extension of time and/or adjustment of the contract price, then the contractor must take the necessary steps to initiate ordinary court or arbitration proceedings no later than eight months after take-over of the contract work.

The contractor shall issue a final account proposal and the final invoice within two months after take-over. If the contractor fails to do so, the employer is entitled to set a final deadline, which shall not be shorter than 14 days. If the contractor fails to submit the final account, then he loses (with certain exceptions) the right to make any claims in connection with the contract against the employer.

It should also be noted that any claims may become time-barred in accordance with the Norwegian Limitation Act, regardless of the agreed mechanisms in the contract. Claims will in general be time-barred three years after the date on which the creditor first had the right to demand performance.

Further, according to NS 8407, the employer must present guarantee claims without undue delay and within five years after take-over at the latest (guarantee period).

3.6 Which party usually bears the risk of unforeseen ground conditions under construction contracts in your jurisdiction?

According to NS 8407, the employer bears the risk for unforeseen ground conditions if they deviate from what the contractor had reason to expect when preparing its tender. However, the contractor is obliged to take into account all available information in connection with the preparation of its tender as further detailed in the standard contract.

3.7 Which party usually bears the risk of a change in law affecting the completion of the works under construction contracts in your jurisdiction?

According to NS 8407, the employer bears the risk of a change in law affecting the performance of the works. The contractor must notify the employer thereof without undue delay. However, this only applies if the contractor could not have been expected to take into account such changes to laws and regulations at the time the tender was submitted and could not have been expected to avoid the consequences.

3.8 Which party usually owns the intellectual property in relation to the design and operation of the property?

Unless otherwise agreed, the employer shall only be entitled to use the design work for the completion of the project, subsequent operations, maintenance, alterations or extensions. All other rights to the design work shall continue to be held by the party that has prepared the design work.

3.9 Is the contractor ever entitled to suspend works?

According to NS 8407, the contractor is entitled to suspend performance of the work if the employer is in substantial breach of its payment obligation or if it is evident that such breach will occur. The contractor must notify the employer of such suspension in writing 24 hours in advance.

3.10 Are there any grounds which automatically or usually entitle a party to terminate the contract? Are there any legal requirements as to how the terminating party's grounds for termination must be set out (e.g. in a termination notice)?

According to NS 8407, a party is entitled to terminate the contract if the other party has substantially breached its contractual obligations, which corresponds with general principles of Norwegian contract law. In addition, a party is entitled to terminate the contract if it is evident that a substantial breach will occur. However, the party in breach shall be given a reasonable deadline for remedying the matter before termination can be implemented.

Further, a party is entitled to terminate the contract if the other party goes bankrupt or becomes insolvent. However, the employer shall not be entitled to terminate the contract if it is proven that the work will be completed in accordance with the contract. Nor shall the contractor be entitled to terminate the contract if satisfactory security is provided for the timely performance of the remaining part of the employer's obligations under the contract.

Except as stated above, NS 8407 does not include any grounds which automatically entitle the innocent party to terminate the contract.

A party must terminate the contract by submitting a written notice to the other party (or to its representative). According to general principles of Norwegian contract law, the notice must be sent within a reasonable time after the other party's breach of contract became known. Further, the party terminating the contract will in most cases be bound by the basis for termination which has been invoked in the termination notice, even if any (general) reservations are made, i.e. the basis for termination can in principle not be supplemented by additional main arguments, at least if not invoked shortly after the notice was submitted.

3.11 Do construction contracts in your jurisdiction commonly provide that the employer can terminate at any time and for any reason? If so, would an employer exercising that right need to pay the contractor's profit on the part of the works that remains unperformed as at termination?

According to NS 8407, the employer is entitled to terminate the contract at its convenience. Such termination for convenience can be effected at any time, but should be "as far in advance as possible". If the contract is only partially terminated, but represents a reduction of at least 15% of the contract price, the termination shall be regarded as a termination for convenience for that part of the work (and not as a negative variation order).

According to NS 8407, the contractor will in such cases be entitled to compensation equal to the financial loss suffered by the contractor due to the termination, i.e. the loss of profit on the part of the works that remains unperformed at the time of termination will be recoverable, as well as all other costs incurred by the contractor (e.g. cancellation fees payable to sub-contractors). However, the contractor must implement all reasonable measures in order to mitigate its financial loss due to the termination.

In Norwegian standard offshore contracts, the parties would rather pre-agree the termination fees, e.g. the employer shall pay the lesser of 4% of the contract price or 6% of the part of the contract price which is not paid at the date of termination (in addition to all costs incurred due to the termination).

3.12 Is the concept of *force majeure* or frustration known in your jurisdiction? What remedy does this give the affected party? Is it usual/possible to argue successfully that a contract which has become uneconomic is grounds for a claim for *force majeure*?

The concepts of both *force majeure* and "frustration" (known as "failed contractual assumption" or "breach of expectations") are, subject to certain conditions, recognised in accordance with the general principles of Norwegian contract law.

In accordance with NS 8407, the parties are entitled to an extension of time if the progress of their obligations is hindered by circumstances outside their control, such as extraordinary weather conditions, orders or prohibitions by public authorities, etc. However, a party shall not be entitled to an extension of time in respect of hindrances which the party should have taken

into account when the contract was entered into or the party could reasonably have avoided or overcome the consequences of such occurrences. The parties are not entitled to any compensation as a result of *force majeure*.

In accordance with Norwegian case law, the contractor's risks (and in principle the employer's risks as well) are limited according to the doctrine of "failed contractual assumptions". In order for a party to succeed with a claim based on this doctrine, the assumption must have been a determining element in the contract (fundamental assumption), and the other party must have been aware of the assumption. In addition, the assumption must be deemed "relevant", which depends on an overall assessment as to what party should carry the risk for the unexpected development.

Based on the above rules, it is not usual, and it must be deemed extremely difficult, to argue successfully that a contract which has become uneconomic is a ground for claiming *force majeure* or a ground for claiming compensation for increased costs, etc.

3.13 Are parties, who are not parties to the contract, entitled to claim the benefit of any contractual right which is made for their benefit? E.g. is the second or subsequent owner of a building able to claim against the contractor pursuant to the original construction contracts in relation to defects in the building?

In accordance with general principles of Norwegian contract law, a third party may be entitled to claim the benefit of a contractual right which is made for its benefit, i.e. that a contract may grant a third party rights, but in general not impose any obligations on any third party. This must be assessed based on an interpretation of the relevant contract.

Further, a contracting party may, unless agreed otherwise, assign its contractual rights (but not obligations) to a third party without the other party's consent.

A second or subsequent owner of a building is, in most cases, regardless of whether a claim or right has been transferred to such subsequent owner, entitled to make claims for defects against the contractor in accordance with the original contract. However, the contractor may (except for mandatory consumer legislation) invoke any limitations of liability, etc. under its contract with the employer against the second or subsequent owner of the building.

3.14 On construction and engineering projects in your jurisdiction, how common is the use of direct agreements or collateral warranties (i.e. agreements between the contractor and parties other than the employer with an interest in the project, e.g. funders, other stakeholders, and forward purchasers)?

Direct agreements or collateral warranties are commonly used in project finance projects, such as wind farm projects.

3.15 Can one party (P1) to a construction contract, who owes money to the other (P2), set off against the sums due to P2 the sums P2 owes to P1? Are there any limits on the rights of set-off?

The right of set-off of a counterclaim against a primary claim is recognised under Norwegian law when the following general conditions are fulfilled:

- (i) the primary claim and the counterclaim must exist between the same parties (except in cases of "connexity", i.e. claims arising out of the same contractual relationship);
- (ii) the primary claim and the counterclaim must be of the same nature;
- (iii) the time of discharge of the primary claim must have occurred; and
- (iv) the counterclaim must be due and payable.

A set-off must be declared. A written notice would be preferable, but there are no strict form requirements under Norwegian law.

3.16 Do parties to construction contracts owe a duty of care to each other either in contract or under any other legal doctrine? If the duty of care is extra-contractual, can such duty exist concurrently with any contractual obligations and liabilities?

According to NS 8407, both parties have a duty to cooperate and show loyalty during the performance of the contract, which is in line with the general principles of Norwegian contract law. A breach of a party's fiduciary duties may, *inter alia*, result in liability for damages and loss of rights under the contract.

To the extent that the duty of care is extra-contractual (i.e. not included as part of the contract terms, but nonetheless applicable pursuant to general principles of Norwegian contract law), such duty can in principle exist concurrently with any contractual obligations and liabilities. However, the existence of specific remedies in relation to certain breaches/issues may be considered as the sole remedies available in any related cases, or in any event make it challenging to succeed with any additional remedies than those stated in the contract.

3.17 Where the terms of a construction contract are ambiguous, are there rules which will settle how that ambiguity is interpreted?

When interpreting a construction contract, the judge's aim is to determine the meaning intended by the parties. A basic principle of interpretation of contracts is that an agreement must, regardless of the wording, be interpreted in accordance with the joint intention of the parties at the time the agreement was entered into.

In respect of commercial contracts, the wording is of particular importance and often given decisive weight. If, however, the wording is unclear and other relevant circumstances (previous negotiations, subsequent conduct, the purpose, etc.) are insufficient to conclude on the interpretation issue, then the contract will often be interpreted against the interests of the party who provided the wording (*contra proferentem* doctrine).

3.18 Are there any terms which, if included in a construction contract, would be unenforceable?

The Norwegian standard construction contracts do not include unenforceable terms and there are, in general, no terms which would, if included in the contract, be unenforceable.

However, section 36 of the Norwegian Contract Act allows for full or partial revision of any contract term if it must be considered "*unreasonable or contrary to prudent business practice to enforce it*". The fact that most construction contracts are entered into between professional parties with a specific and well-considered risk allocation makes it very challenging to succeed with a claim on this basis.

3.19 Where the construction contract involves an element of design and/or the contract is one for design only, are the designer's obligations absolute or are there limits on the extent of his liability? In particular, does the designer have to give an absolute guarantee in respect of his work?

In construction contracts which involve an element of design and/or the contract is for design only, the designer has in general undertaken an obligation as to the result, which may be characterised as “absolute”, i.e. the contractor is responsible for the delivery of a contract object in line with the terms and conditions of the contract.

The designer is not obliged to give absolute guarantees in respect of his work. In accordance with the principle of contractual freedom, the parties may agree on whatever terms, including limited guarantees/warranties.

According to NS 8407, the guarantee period is set to five years from take-over of the contract object and the contractor is, in principle, not liable for the employer's consequential losses.

In NS 8401 (standard contract for design only), the contractor's liability for damages is, unless otherwise agreed, limited to approximately MNOK 5.8 for liability which is not covered by insurance, and approximately MNOK 14.5 for liability covered by insurance.

3.20 Does the concept of decennial liability apply in your jurisdiction? If so, what is the nature of such liability and what is the scope of its application?

The concept of “decennial liability” is not applicable in accordance with Norwegian law.

4 Dispute Resolution

4.1 How are construction disputes generally resolved?

Disputes arising in connection with a construction contract, and which are not resolved by mutual agreement, are normally settled by ordinary court proceedings at the agreed legal venue (or the right legal venue in accordance with Norwegian procedural legislation) unless the parties agree otherwise, e.g. arbitration.

According to NS 8407, the parties may, unless agreed otherwise and until take-over, also demand that a dispute be determined by an umpire (temporary dispute resolution). Such decision shall be binding on the parties if the parties fail to bring an umpire decision before a court or arbitration tribunal within six months of the date of the decision.

4.2 Do you have adjudication processes in your jurisdiction (whether statutory or otherwise) or any other forms of interim dispute resolution (e.g. a dispute review board)? If so, please describe the general procedures.

In Norway, we do not have an adjudication process as such. However, there is voluntary court-administered mediation. The purpose of such mediation is that the parties, with the collaboration of a judge (mediator), try to solve the dispute amicably.

Further, pursuant to NS 8407, the parties may agree on establishing a so-called “project integration mediation panel” (“PRIME”) with a mandate to assist the parties in resolving any disputes which arise during the contract period. The panel will usually consist of three members that have been appointed jointly by the parties. The purpose is to provide a forum for resolving any disputes amicably, and the mediation panel should

be appointed in an early phase of the contract work. The panel's decisions will not be binding and final unless such effect has been agreed between the parties.

4.3 Do the construction contracts in your jurisdiction commonly have arbitration clauses? If so, please explain how, in general terms, arbitration works in your jurisdiction.

According to NS 8407, disputes shall be settled by ordinary court proceedings unless it has been agreed to refer disputes to arbitration. However, arbitration is often used as a dispute resolution mechanism in construction contracts in Norway.

The Norwegian Arbitration Act is based on the UNCITRAL Model Law on International Commercial Arbitration, follows the Model Law closely in structure and content, and can be considered a national implementation of the Model Law, with certain variations. Generally, and as the main rule, parties are free to agree on the terms governing the arbitration proceedings. The Arbitration Act contains only a few mandatory provisions.

Section 20 of the Arbitration Act, corresponding to Article 18 of the Model Law, confirms that the parties must receive equal treatment at every stage of the arbitral proceedings.

Section 20 also adopts the principle that both parties are fully entitled to present their cases. It is emphasised in section 28 that the parties are responsible for clarifying the facts of the case and that they are entitled to present such evidence as they wish. Under this section, the arbitral tribunal may, however, refuse to accept evidence which is clearly not relevant and also, to some extent, based on proportionality.

The Arbitration Act only specifies a few procedural rules. To the extent that neither of the parties have agreed on what shall apply in other respects, the tribunal may apply the rules it considers appropriate.

The principle of orality (i.e. that the parties, their counsel and witnesses must express themselves orally before the court) and the principle of immediacy (i.e. that all evidence must be presented before the court that is to render the judgment) are fundamental principles in legal proceedings in the ordinary courts of Norway. In arbitration, these principles are not given the same prominence, but are to a considerable extent adopted in most arbitral proceedings.

The provisions of sections 12 and 13 of the Arbitration Act concerning the appointment of arbitrators correspond to a great extent, in terms of their content, to Articles 10 and 11 of the Model Law. Thus, the parties are free to determine the appointment procedure. The speed at which the tribunal can be set up depends on the parties, as long as they agree. The Arbitration Act provides that the parties must, to the greatest extent possible, jointly appoint the arbitral tribunal. This will, at the outset, place an obligation on the parties to spend some time ascertaining whether they can reach an agreement on a joint appointment.

If the parties are unable to agree on who should be appointed, the appointment procedure is in essence similar to that provided in Articles 10 and 11 of the Model Law: unless otherwise agreed, the tribunal shall consist of three arbitrators. Each party must appoint an arbitrator within one month of being requested to do so by the other party. These two arbitrators shall thereafter together appoint the presiding arbitrator within one month.

If a party fails to act as required under the applicable appointment procedure, if the two party-appointed arbitrators are unable to reach agreement on the third arbitrator, or if an appointing body fails to act as provided, each of the parties may under section 13 (4) of the Arbitration Act request the relevant district court to appoint the remaining arbitrator(s).

Arbitration awards are not subject to any appeal. The only recourse against an arbitral award is to bring an action before the courts claiming the setting aside of the award.

Lastly, we must also mention the Nordic Offshore & Maritime Arbitration Association (“NOMA”), which was established in 2017 on the initiative of the Danish, Finnish, Norwegian and Swedish Maritime Law Associations. NOMA has established rules and best practice guidelines for the parties and the tribunal. A recommended arbitration clause is available on NOMA’s webpage. Despite its name, NOMA and its guidelines may be used in all kinds of construction projects. As an alternative, the parties may refer disputes to the Arbitration and Dispute Resolution institute of the Oslo Chamber of Commerce, which has prepared rules for arbitration, fast-track arbitration and mediation.

4.4 Where the contract provides for international arbitration, do your jurisdiction’s courts recognise and enforce international arbitration awards? Please advise of any obstacles (legal or practical) to enforcement.

Pursuant to section 45 (1) of the Arbitration Act, an arbitration award shall be recognised and enforceable, irrespective of the country in which it was made. This means that arbitration awards made in countries not party to the New York Convention are also recognised and enforceable in Norway.

However, for an arbitral award to be recognised and enforced, certain conditions have to be met, *cf.* section 45 (2) of the Arbitration Act. A party has to make available the original arbitration award or a certified copy of the award. If the arbitral award has not been made in one of the Scandinavian languages (Norwegian, Swedish or Danish) or in English, the party must also make available a certified translation of the arbitration award.

The court (or administrative agency) may also request the existence of an arbitration agreement to be proved.

Regardless of whether an arbitral award is recognised and enforceable, recognition and enforcement may, however, be refused pursuant to section 46 of the Arbitration Act. This provision corresponds to a large extent to Article 36 (1) of the Model Law and Article V of the New York Convention.

Pursuant to section 46 (1) of the Arbitration Act, recognition or enforcement may be refused at the request of the party against whom it is invoked, if that party furnishes evidence that one of the parties to the arbitration agreement lacked legal capacity or the arbitration agreement is not valid. Such refusal may also result where certain procedural errors – concerning notice to the parties, jurisdiction of the tribunal, etc. – have been made.

The court (or the administrative agency) shall, pursuant to section 46 (2) of the Arbitration Act, of their own accord refuse to recognise and enforce an award if the dispute could not be settled by arbitration under Norwegian law or if recognition and enforcement would be contrary to “*ordre public*”.

4.5 Where a contract provides for court proceedings in your jurisdiction, please outline the process adopted, any rights of appeal and a general assessment of how long proceedings are likely to take to reduce: (a) a decision by the court of first jurisdiction; and (b) a decision by the final court of appeal.

The main elements of ordinary court proceedings in Norway may be summarised as follows:

- Before the plaintiff files the writ of summons to the court, the plaintiff must notify the defendant in writing that the plaintiff is considering initiating court proceedings.

- The case commences when the plaintiff files a writ of summons to the court of first instance (city court). The writ shall state the claims invoked by the plaintiff and set out the factual and legal assertions on which the claims are based. In addition, the evidence on which the plaintiff wishes to rely must be submitted, but additional evidence may also be presented at a later stage.
- The defendant will then be given a deadline (usually three weeks) for submitting a reply.
- Thereafter, further communication with the court and the other side, including the submission of additional arguments and evidence, is carried out by submitting written pleadings.
- An oral hearing shall in principle be held within six months from the date on which the writ of summons was filed. In practice, the scheduling of the hearing depends on the workload of the court as well as the complexity of the case.
- The hearing is divided into three parts: the opening arguments (where written evidence is normally presented); the evidence (party and witness testimonies); and the closing arguments.
- The court shall render the judgment within two weeks from the date on which the hearing was adjourned (four weeks if there is more than one judge), but the deadline is often postponed. The judge will normally indicate when the judgment can be expected at the end of the hearing.
- The parties have the right to appeal. The deadline for appeal is one month from the day that the judgment is served. The court of appeal may refuse leave to appeal against a judgment if it finds it clear that the appeal will not succeed. However, only on rare occasions does the court of appeal refuse to hear an appeal.
- The hearing of the appeal will likely be held six to 12 months after the appeal is submitted. The court of appeal shall in principle render the judgment within four weeks from the date on which the hearing was adjourned.
- A judgment rendered by the court of appeal may also be appealed to the Norwegian Supreme Court. However, judgments cannot be appealed without leave. Leave can only be granted if the appeal concerns issues whose significance extends beyond the scope of the current case, or if it is important for other reasons that the case is determined by the Supreme Court. In construction cases, it is extremely rare that the Supreme Court accepts to hear the appeal.

Based on the above, we estimate that a judgment by the court in the first instance may be delivered within six to 12 months after submission of the writ of summons. A judgment from the court of appeal – which in most cases will be the “final court of appeal” – may thereafter be delivered within seven to 12 months of the submission of the notice of appeal.

4.6 Where the contract provides for court proceedings in a foreign country, will the judgment of that foreign court be upheld and enforced in your jurisdiction? If the answer depends on the foreign country in question, are there any foreign countries in respect of which enforcement is more straightforward (whether as a result of international treaties or otherwise)?

A judgment rendered by a foreign court will only be recognised as a final and enforceable judgment to the extent prescribed by law. In accordance with the Norwegian Dispute Act, the Lugano Convention of 2007 between the EU and the EFTA countries (including Norway) shall be deemed implemented into Norwegian law by way of incorporation, and Chapter III of the

Lugano Convention concerns recognition and enforcement of judgments. Consequently, judgments from countries party to the Lugano Convention of 2007 may be enforced in Norway. As for judgments from outside the EU, such judgments may be enforceable in Norway in accordance with treaties between the states.

In addition, a foreign judgment is enforceable in Norway if the parties have agreed to refer disputes under a contract to a foreign court. Thus, if the parties agree that disputes arising

out of the contract shall be solved by court proceedings abroad, then the judgment will in principle be enforceable in Norway. However, enforcement of foreign judgments in Norway will in practice be more “straightforward” if the party may rely on the Lugano Convention of 2007 or an international treaty governing enforcement of judgments between the two jurisdictions in question.



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1 Making Construction Projects

1.1 What are the standard types of construction contract in your jurisdiction? Do you have: (i) any contracts which place both design and construction obligations upon contractors; (ii) any forms of design-only contract; and/or (iii) any arrangement known as management contracting, with one main managing contractor and with the construction work done by a series of package contractors? (NB For ease of reference throughout the chapter, we refer to “construction contracts” as an abbreviation for construction and engineering contracts.)

Construction-only contracting remains the most common procurement method in the Kingdom of Saudi Arabia (“KSA”) and this is often effected through the use of amended versions of the International Federation of Consulting Engineers’ (“FIDIC”) 1999 Red Book (although the 1987 edition is also widely used). However, Design and Build contracting is gaining popularity, and the FIDIC 1999 Yellow Book is usually used as a base document in this regard.

As in many other jurisdictions, industrial projects are frequently delivered on a turnkey basis. Although the FIDIC 1999 Silver Book is well known (and is often used subject to significant amendments), bespoke forms of engineering, procurement and construction (“EPC”) contracts are also executed.

As employers in KSA place significant importance on single-point responsibility, engineering, procurement and construction management (“EPCM”) contracting is infrequently used (although its popularity may well increase as KSA’s implementation of Vision 2030 gains traction).

1.2 How prevalent is collaborative contracting (e.g. alliance contracting and partnering) in your jurisdiction? To the extent applicable, what forms of collaborative contracts are commonly used?

Collaborative contracting is seldom used in KSA. As this form of procurement is used exceptionally, no particular form of contract for this form of procurement is in common circulation.

1.3 What industry standard forms of construction contract are most commonly used in your jurisdiction?

As noted in our response to question 1.1, FIDIC forms of contract (albeit subject to amendments) are generally used in KSA.

1.4 What (if any) legal requirements are there to create a legally binding contract (e.g. in common law jurisdictions, offer, acceptance, consideration and intention to create legal relations are usually required)? Are there any mandatory law requirements which need to be reflected in a construction contract (e.g. provision for adjudication or any need for the contract to be evidenced in writing)?

To form a legally binding contract in KSA, there must be:

- (a) an offer by one party;
- (b) acceptance of that offer by the counterparty;
- (c) certainty as to the subject matter and price;
- (d) sufficient capacity to contract; and
- (e) compliance with principles of *Shari’ah*.

Although the principle of freedom of contract is generally respected in KSA, *Shari’ah* principles prohibit the charging of interest as well as contracts for assets that are not yet in existence. However, construction contracts are exempted from the latter prohibition provided that the contract price and completion date are pre-agreed.

There is no requirement for a contract to be evidenced in writing (although there may well be evidential challenges if this is not the case), and there is no mandatory dispute resolution mechanism.

1.5 In your jurisdiction please identify whether there is a concept of what is known as a “letter of intent”, in which an employer can give either a legally binding or non-legally binding indication of willingness either to enter into a contract later or to commit itself to meet certain costs to be incurred by the contractor whether or not a full contract is ever concluded.

In accordance with principles of freedom of contract, letters of intent are used and are enforceable in KSA (subject to the requirements of contract formation being satisfied).

1.6 Are there any statutory or standard types of insurance which it would be commonplace or compulsory to have in place when carrying out construction work? For example, is there employer’s liability insurance for contractors in respect of death and personal injury, or is there a requirement for the contractor to have contractors’ all-risk insurance?

The Saudi Ministry of Investment (previously known as the Saudi Arabia General Investment Authority) imposes certain insurance requirements on construction projects, such as requiring foreign entities engaging in such projects to “obtain insurance against the company’s errors in implementation of the project”. Significantly,

decennial liability insurance (also known as Inherent Defects Insurance) was made mandatory in December 2018, (pursuant to a Ministerial Decision on 06/09/1441 in the Hijri calendar (“H”), corresponding to 01/05/2020 in the Gregorian calendar).

In practice and as is typical in the international construction sector, employers invariably require contractors and consultants to carry professional indemnity insurance to the extent that they have design responsibility or are otherwise providing professional services.

Other than in respect of “employer risk events” specified under the relevant contract, a contractor is usually required to insure the works until they have been taken over. Additionally, contractors are generally required to take out and maintain workers’ compensation insurance and public liability insurance.

Delaying start-up insurance is becoming increasingly popular in industrial projects, particularly if recourse from delay damages is likely to be insufficient.

1.7 Are there any statutory requirements in relation to construction contracts in terms of: (a) labour (i.e. the legal status of those working on site as employees or as self-employed sub-contractors); (b) tax (payment of income tax of employees); and/or (c) health and safety?

Labour

KSA’s policy of Saudisation (*Nitaqat*) requires a minimum number of Saudis to be employed by a business. This minimum number depends on the type of company, industry and job title. Under *Nitaqat*, businesses with higher numbers of Saudi employees have greater privileges for foreign visa requests.

Additionally, foreign entities engaged in public works contracts are required to share 30% of the work with Saudi nationals (but an entity that is majority Saudi-owned is exempt from this requirement).

Non-Saudi employees must have entered the country on a valid employment visa. Further, employers are required to obtain work and residency permits (*Iqama*) for employees within 90 days of arrival.

Tax

No income tax on individuals is charged in KSA. However, withholding tax applies to the transfer of monies to a payee residing outside of KSA while corporate income tax (at a rate of 20%) is paid on all gross income received by businesses in KSA. *Zakat* is a wealth tax imposed only on individuals and businesses located in Gulf Cooperation Council (“GCC”) countries who are shareholders of companies registered in KSA. The applicable rate is 2.5%.

Health and Safety

The primary source of law is Royal Decree No. M/51/2005, which applies to construction projects and imposes various rights and obligations on stakeholders. Additional rules, procedures and restrictions have recently been implemented to combat the spread of COVID-19.

1.8 Is the employer legally permitted to retain part of the purchase price for the works as a retention to be released either in whole or in part when: (a) the works are substantially complete; and/or (b) any agreed defects liability period is complete?

Retentions are prevalent in the market, in respect of which it is not unusual for 10% of each interim payment to be retained and for half of the agreed retained amount to be released to the

contractor upon takeover of the works, with the balance being paid upon the expiry of the defects liability period. However, the entire retention is sometimes withheld until the expiry of the defects liability period, particularly if the employer does not have any other form of security in place.

1.9 Is it permissible/common for there to be performance bonds (provided by banks and others) to guarantee the contractor’s performance? Are there any restrictions on the nature of such bonds? Are there any grounds on which a call on such bonds may be restrained (e.g. by interim injunction); and, if so, how often is such relief generally granted in your jurisdiction? Would such bonds typically provide for payment on demand (without pre-condition) or only upon default of the contractor?

On-demand performance bonds are almost always required, typically in the sum of 10% of the contract price, but default bonds are unusual in KSA. Although the entire value of the performance bond can remain in place until the expiry of the defects liability period, it is not uncommon for the value of the performance bond to reduce by 50% upon takeover, particularly if the employer is holding a retention.

It is unusual for a call to liquidate an on-demand performance bond to be prevented, and typically this can only be achieved if it can be demonstrated that the liquidation would be an abusive act or manifestly wrong. These are significant hurdles to overcome, while there is usually a very limited period between the date upon which the request for the bond to be liquidated is issued by the beneficiary, and the date upon which the bank complies with the request and duly encashes the performance bond. However, an injunction would only typically be granted on the basis that the contractor imminently files a substantive claim against the party seeking to liquidate the performance bond.

1.10 Is it permissible/common for there to be company guarantees provided to guarantee the performance of subsidiary companies? Are there any restrictions on the nature of such guarantees?

A parent company guarantee is a “creature of contract” and, while not as common as in certain jurisdictions, parent company guarantees do feature in the construction market in KSA (particularly in the context of larger projects being undertaken by the local subsidiaries of international contractors).

1.11 Is it possible and/or usual for contractors to have retention of title rights in relation to goods and supplies used in the works? Is it permissible for contractors to claim that, until they have been paid, they retain title and the right to remove goods and materials supplied from the site?

Public works are subject to the new Government Tenders and Procurement Law, which was approved by the Council of Ministers on 16.07.2019 (the “**Procurement Law**”). The Procurement Law, which applies to government bodies (as well as companies that are majority-owned by the government), provides that a contractor cannot remove equipment, temporary works or materials from the site without the written approval of the engineer.

In the private sector, freedom of contract allows the parties to determine their own terms in respect of title. In our experience, the majority of construction contracts provide that title to goods and the like passes to the employer on the earlier of delivery to the site or payment.

2 Supervising Construction Contracts

2.1 Is it common for construction contracts to be supervised on behalf of the employer by a third party (e.g. an engineer)? Does any such third party have a duty to act impartially between the contractor and the employer? If so, what is the nature of such duty (e.g. is it absolute or qualified)? What (if any) recourse does a party to a construction contract have in the event that the third party breaches such duty?

Given that FIDIC-based contracts are commonly used in KSA, it is usual for the work to be supervised and for the contract to be administered by an engineer. Although these forms of contract usually require the engineer to act “fairly” or “impartially”, the fact that the engineer is engaged by the employer can be a source of concern for contractors.

Given that a contractor is highly unlikely to have a contractual relationship with the engineer, the contractor would need to claim against the engineer in tort and this would fundamentally require the contractor to demonstrate that the engineer failed to act in good faith. However, this is typically a very significant evidential burden to discharge, while tort claims for economic loss are difficult to maintain.

2.2 Are employers free to provide in the contract that they will pay the contractor when they, the employer, have themselves been paid; i.e. can the employer include in the contract what is known as a “pay when paid” clause?

There is no prohibition against conditional payment arrangements, and these are a typical feature of subcontracts in KSA. However, subcontractors are well advised to insert certain protections to mitigate the potential harshness of conditional payment regimes (such as seeking transparency regarding payments made under the main contract, requiring the main contractor to negotiate with the employer for payment in good faith on their behalf, and seeking to make the conditional payment regime subject to thresholds).

2.3 Are the parties free to agree in advance a fixed sum (known as liquidated damages) which will be paid by the contractor to the employer in the event of particular breaches, e.g. liquidated damages for late completion? If such arrangements are permitted, are there any restrictions on what can be agreed? E.g. does the sum to be paid have to be a genuine pre-estimate of loss, or can the contractor be bound to pay a sum which is wholly unrelated to the amount of financial loss likely to be suffered by the employer? Will the courts in your jurisdiction ever look to revise an agreed rate of liquidated damages; and, if so, in what circumstances?

Most construction contracts in KSA entitle the employer to claim delay damages in the event that the time for completion is not achieved on account of the contractor’s culpable delay. Delay damages usually accrue at a prescribed daily rate and are subject to an aggregate cap of the contract price (which, when exhausted, usually triggers a ground for termination).

Although delay damages are subject to the principle of freedom of contract (while there is no prohibition regarding penalties, as is the case in certain jurisdictions), a delay damages regime may be challenged (pursuant to *Shari’ah* principles) if the actual loss suffered is significantly different from the amount of delay damages charged. However, we are only aware of courts decreasing (not increasing) the delay damages that are payable.

3 Common Issues on Construction Contracts

3.1 Is the employer entitled to vary the works to be performed under the contract? Is there any limit on that right?

The Procurement Law provides that, in the context of publicly awarded contracts, the value of additional works cannot exceed 10% of the contract price, while the value of omitted works cannot exceed 20% of the contract price.

The principle of freedom of contract applies to contracts which are not subject to the Procurement Law, and it is not unusual for no thresholds to be prescribed. However, certain contracts (including some FIDIC forms) prohibit omitted works from subsequently being awarded to third parties, while contractors occasionally retain the ability to claim loss of profit (which cannot be speculative) in respect of omitted works.

3.2 Can work be omitted from the contract? If it is omitted, can the employer carry out the omitted work himself or procure a third party to perform it?

Please see our response to question 3.1 above.

3.3 Are there terms which will/can be implied into a construction contract (e.g. a fitness for purpose obligation, or duty to act in good faith)?

Shari’ah principles impose a general duty, on all parties, to act in good faith. However, the concept of fitness for purpose is not recognised at law and will therefore only apply to the extent that this is a contractually agreed requirement.

3.4 If the contractor is delayed by two concurrent events, one the fault of the contractor and one the fault or risk of his employer, is the contractor entitled to: (a) an extension of time; and/or (b) the costs arising from that concurrent delay?

KSA law does not expressly address concurrent delay.

Parties are therefore encouraged to clearly address the position under the construction contract, in respect of which it is not unusual for the contractor to be entitled to an extension of time but to have no entitlement to costs for the duration of the concurrent delay.

In the absence of a contractual agreement between the parties, the courts typically adopt a flexible approach whereby the situation is considered holistically (with regard being paid to the overall conduct of the parties), and we are aware of the principle of apportionment being applied.

3.5 Is there a time limit beyond which the parties to a construction contract may no longer bring claims against each other? How long is that period and when does time start to run?

The Commercial Court is the competent court to hear disputes between two private parties. The Commercial Courts Law (issued on 14/08/1441H, corresponding to 17/04/2020 and which will come into effect two months after its publication in the Official Gazette) provides that a limitation period of five years from the

date the cause of action accrues applies (although this period may be extended at the discretion of the court).

Conversely, a limitation period of 10 years applies to actions before the Administrative Court (Board of Grievances), which is the competent court to hear disputes between a government party and a private party.

3.6 Which party usually bears the risk of unforeseen ground conditions under construction contracts in your jurisdiction?

Although this risk allocation can be rebalanced by the parties, it is nevertheless typical for parties to agree that the employer remains responsible for unforeseen ground conditions (and this position is typically endorsed by courts). However, the concept of what was foreseeable or otherwise is inherently uncertain, so parties are well advised to insert drafting to elaborate on this issue.

3.7 Which party usually bears the risk of a change in law affecting the completion of the works under construction contracts in your jurisdiction?

This is a matter for commercial negotiation in the context of private entities. Under certain unamended FIDIC forms (such as the 1999 Red Book), the contractor is entitled to both an extension of time and costs to the extent that it is affected by a change in law. However, this risk allocation is frequently revised. For example, it may be agreed that that relief is only available in respect of unforeseeable changes in law, relief may be subject to pre-agreed thresholds, and it also would not be unusual to limit the contractor's compensation to an extension of time (particularly as this is frequently a risk in respect of which the employer exercises no control).

However, the Procurement Law regulates the issue of change in law in the context of government contracts, and provides that the contract price shall be fixed other than in respect of: (i) changes to the price of officially priced basic materials or services included in the tender; (ii) changes to customs tariffs, fees or taxes; and (iii) unforeseen circumstances or financial difficulties beyond the contractor's control.

3.8 Which party usually owns the intellectual property in relation to the design and operation of the property?

Intellectual property rights vest in the creator of the deliverable, and payment of a fee to, say, the design consultant is not necessarily sufficient to confer an implied intellectual property licence upon the employer. It is therefore important that the parties expressly address the issue of intellectual property rights in the relevant contracts.

3.9 Is the contractor ever entitled to suspend works?

The Procurement Law prohibits suspension in the context of government projects, but the contractor's right to suspend under contracts that are not subject to the Procurement Law is a matter for negotiation.

If the contract is silent on the contractor's right of suspension, a court may be sympathetic to a contractor who suspends performance on account of non-payment of a certified amount, or if the employer (or the supervisor) refuses to issue payment certificates. However, the court is likely to consider the position

holistically and would be less sympathetic if, for example, a relatively minor amount is outstanding or if a delay in making payment is relatively insignificant.

3.10 Are there any grounds which automatically or usually entitle a party to terminate the contract? Are there any legal requirements as to how the terminating party's grounds for termination must be set out (e.g. in a termination notice)?

Under the Procurement Law, the relevant government entity is required to terminate a contract in the event of fraud/bribery, insolvency or assignment by the contractor without consent. The relevant government entity has the discretion to terminate the underlying contract in the event of breach by the contractor (including in the event of slow progress or if a breach is not remedied within a cure period of 15 days), in the event of the contractor subcontracting without consent, or if termination is in the public interest.

Grounds for termination outside of the Procurement Law are a matter for commercial negotiation and, for example, contractors typically request the right to terminate if the employer fails to certify works or fails to make due payments (although such rights usually only apply following a period of suspension).

A party may also petition the court to terminate a contract in the absence of a contractual right to do so. However, a court will usually only order termination (or cancellation) in exceptional circumstances and where it is clear that it is inappropriate for performance to continue.

3.11 Do construction contracts in your jurisdiction commonly provide that the employer can terminate at any time and for any reason? If so, would an employer exercising that right need to pay the contractor's profit on the part of the works that remains unperformed as at termination?

Employers typically require the ability to terminate for convenience. The resultant compensation regime is a matter for negotiation, but the contractor's entitlements tend to align with consequences that apply in the event of the contractor's termination for cause. However, we would typically expect the employer to exclude liability for loss of profit (which is often a mutually applicable exclusion), while employers generally insert drafting to allow them the flexibility to engage a third party to undertake the omitted part of the works.

3.12 Is the concept of *force majeure* or frustration known in your jurisdiction? What remedy does this give the affected party? Is it usual/possible to argue successfully that a contract which has become uneconomic is grounds for a claim for *force majeure*?

Contracts frequently address the issue of *force majeure*, including in respect of defining the concept as well as its consequences, and an event of *force majeure* may trigger termination under the Procurement Law.

In the absence of a contractually agreed *force majeure* regime, KSA law provides that impossibility may trigger a basis for either party (who has the burden of proving impossibility) to request that the contract be terminated. If an event of *force majeure* only renders performance of part of the contract impossible, then only the affected party's obligations in relation to that part will be severed (but the balance of the contract will otherwise remain in place).

The concept of *force majeure* interfaces with the principle of *Gharar* (which translates as hazardous or risky transaction). Under this principle, a party can argue that a contract should be set aside if continued performance has become unduly onerous or uncertain (by reference to the contract). However, the party seeking relief in this regard has a significant evidential burden to overcome in order to be permitted by a court to rely on *Gharar*.

3.13 Are parties, who are not parties to the contract, entitled to claim the benefit of any contractual right which is made for their benefit? E.g. is the second or subsequent owner of a building able to claim against the contractor pursuant to the original construction contracts in relation to defects in the building?

The principle of privity of contract applies in KSA, meaning that third parties cannot enforce the terms of the underlying construction contract (unless a collateral warranty is in place). In the absence of a contractual relationship between the parties, an action in tort would need to be brought, but such actions are difficult to maintain in the context of economic loss. A further cause of action may exist in the context of decennial liability in the event of the collapse of the building, or if it can be shown that its structural integrity has been undermined.

3.14 On construction and engineering projects in your jurisdiction, how common is the use of direct agreements or collateral warranties (i.e. agreements between the contractor and parties other than the employer with an interest in the project, e.g. funders, other stakeholders, and forward purchasers)?

As the principle of privity of contract is recognised in KSA, third-party rights are best recognised by requiring contractors and sub-contractors to enter into collateral warranties or direct agreements with third-party beneficiaries (such as funders and purchasers), which may incorporate step-in rights. As a general observation, collateral warranties and direct agreements are less prevalent in KSA than is the case in other markets (although these instruments are increasing in popularity, particularly where external financing is involved).

3.15 Can one party (P1) to a construction contract, who owes money to the other (P2), set off against the sums due to P2 the sums P2 owes to P1? Are there any limits on the rights of set-off?

The general principle of set-off is recognised at law but is only likely to be enforced in clear instances of significant sums (relative to the value of the contract) being due. No thresholds or limits are addressed at law.

To avoid ambiguity, it is therefore typical for parties to contractually agree the parameters of the set-off regime.

3.16 Do parties to construction contracts owe a duty of care to each other either in contract or under any other legal doctrine? If the duty of care is extra-contractual, can such duty exist concurrently with any contractual obligations and liabilities?

Pursuant to overriding *Shari'ah* principles, parties are required to discharge their obligations in good faith. This is an extra-contractual and mandatory duty that applies concurrently with contractually agreed obligations.

3.17 Where the terms of a construction contract are ambiguous, are there rules which will settle how that ambiguity is interpreted?

There are no fixed rules regarding how ambiguous contractual terms are to be interpreted (such as the *contra proferentem* principle) but drafting, including in the form of priority of documents clauses, can be agreed to address this issue. Additionally, the intention of the parties is usually deciphered from market practice and/or from the parties' conduct.

3.18 Are there any terms which, if included in a construction contract, would be unenforceable?

The general principle is that all contractually agreed terms are permitted unless prohibited by *Shari'ah* principles. Although *Shari'ah* principles are far more applicable to, say, banking and finance than to construction contracts, the court reserves the discretion, in exceptional circumstances, to step in at the request of a party, if it considers that agreed terms are particularly unfair and/or contravene principles of good faith (to be considered and determined on a case-by-case basis). Additionally, any entitlement to indirect losses is susceptible to challenge on the basis that it is speculative and therefore contrary to *Shari'ah* principles, as is the concept of changing interest on late payments.

3.19 Where the construction contract involves an element of design and/or the contract is one for design only, are the designer's obligations absolute or are there limits on the extent of his liability? In particular, does the designer have to give an absolute guarantee in respect of his work?

No absolute duties or design obligations are implied at law and, in the absence of a contractual provision to the contrary, a designer is likely to be held to a standard of reasonable skill. For this reason, design agreements typically set out the standard of care that the designer is required to attain, and it is not uncommon for designers to agree to fitness-for-purpose warranties (although it is prudent to elaborate on what is meant by this obligation, given that this principle is not based on KSA law).

3.20 Does the concept of decennial liability apply in your jurisdiction? If so, what is the nature of such liability and what is the scope of its application?

Decennial liability applies to the total or partial collapse of a structure on account of a construction defect, and applies for a period of 10 years from the date of handover (although the parties can agree to a short limitation period). As noted in our response to question 1.6, contractors are now required to take out and maintain decennial liability insurance.

4 Dispute Resolution

4.1 How are construction disputes generally resolved?

In our experience, the majority of disputes are amicably resolved through direct negotiation (although it is important to note that the "without prejudice" principle does not exist in KSA, so appropriate safeguards need to be put in place prior to the commencement of discussions).

If amicable settlement fails, then the dispute is generally determined by litigation or arbitration.

In terms of litigation, the Commercial Court is the competent court to hear disputes between two private parties, whilst the Administrative Court (Board of Grievances) has jurisdiction over disputes that involve government entities.

4.2 Do you have adjudication processes in your jurisdiction (whether statutory or otherwise) or any other forms of interim dispute resolution (e.g. a dispute review board)? If so, please describe the general procedures.

The Commercial Courts Law (issued on 14/08/1441H, corresponding to 17/04/2020) provides that, prior to proceeding to litigation, the parties must try resolve the dispute in question by means of conciliation and mediation for a period that does not exceed 30 days.

Further, the Procurement Law (as set out the Regulations) states that disputes shall be reviewed by a committee and that the resolution of the committee shall be binding on the government entity in question (but not on the private entity).

4.3 Do the construction contracts in your jurisdiction commonly have arbitration clauses? If so, please explain how, in general terms, arbitration works in your jurisdiction.

Arbitration clauses are a common feature of construction contracts in KSA, in respect of which some key points to note are as follows:

- Royal Decree No. M/34 dated 24/05/1433H (16.04.2012) concerning the approval of the Law of Arbitration came into force on 09.07.2012 (the “**Arbitration Law**”). The Arbitration Law is inspired by the UNCITRAL Model Law and applies to all arbitral proceedings seated in KSA.
- Cabinet Resolution No. 541 of 1438H, which contains the Executive Regulations implementing the Arbitration Law, was issued on 22.05.2017 and came into force on 07.06.2017 (the “**Executive Regulations**”).
- Royal Decree No. 53 dated 13/10/1433H (30.08.2012) concerning the Execution Law came into force on 27.02.2013 (the “**Enforcement Law**”).
- The Saudi Centre for Commercial Arbitration (“**SCCA**”) was formally established by KSA Cabinet Decree No. 257 dated 14/06/1435H (15.03.2014) and became operational in 2016. The SCCA is located in Riyadh. However, there are no restrictions on foreign arbitral providers operating in KSA.
- Arbitration agreements (which are considered to be separate from the underlying contract) must be concluded in writing by parties with the necessary capacity to agree to the dispute being resolved by arbitration.

4.4 Where the contract provides for international arbitration, do your jurisdiction’s courts recognise and enforce international arbitration awards? Please advise of any obstacles (legal or practical) to enforcement.

KSA is a signatory to a number of international conventions (such as the New York Convention, the Riyadh Convention

and the GCC Convention). The enforcement of foreign judgments/awards in KSA is principally regulated by Article 11 of the Enforcement Law, which confers jurisdiction upon the Enforcement Court. The party that is seeking to enforce an award is required to demonstrate that the requirements stipulated under the Enforcement Law have been met, including that:

- courts have no jurisdiction to hear the case (i.e. on the basis that there is a valid arbitration clause);
- the parties were duly summoned, properly represented and enabled to defend themselves;
- the foreign award has become final;
- there is no existing case that concerns the same issues; and/or
- the foreign award does not provide for anything which constitutes a breach of KSA public order or ethics (*Shari’ah* law).

4.5 Where a contract provides for court proceedings in your jurisdiction, please outline the process adopted, any rights of appeal and a general assessment of how long proceedings are likely to take to reduce: (a) a decision by the court of first jurisdiction; and (b) a decision by the final court of appeal.

It typically takes between six and eight months to obtain a first instance judgment.

A dissatisfied party may appeal a first instance judgment to the Court of Appeal, which normally takes up to six months to issue its judgment.

Either party may apply to the Supreme Court for the reversal of judgments rendered or affirmed by the Court of Appeal, provided that the objection is based on one of the following grounds:

- there is a violation of provisions of *Shari’ah* or law;
- the appealed judgment was made by an improper court or by a court that lacked the appropriate jurisdiction; and/or
- there is an error in the characterisation or description of the case.

4.6 Where the contract provides for court proceedings in a foreign country, will the judgment of that foreign court be upheld and enforced in your jurisdiction? If the answer depends on the foreign country in question, are there any foreign countries in respect of which enforcement is more straightforward (whether as a result of international treaties or otherwise)?

The enforcement of foreign judgments in KSA is principally regulated by the Enforcement Law, and the party that is seeking to enforce a foreign court judgment in KSA needs to prove that KSA judgments are enforced in that country.

However, it is significant that KSA is a signatory to the Riyadh Convention, which addresses the recognition and enforcement of foreign judgments and arbitral awards (without reviewing the subject matter of the underlying dispute), provided that such judgments or arbitral awards do not violate public order, morality or overriding principles of *Shari’ah* law.

KSA is also a signatory to the GCC Convention for the Execution of Judgments, Delegations and Judicial Notifications (1996), thus further facilitating the enforcement of judgments emanating from other members of the GCC.



Euan Lloyd heads Al Tamimi & Company's Construction & Infrastructure practice. Euan is admitted as a solicitor in England & Wales and New South Wales, and has practised in a variety of civil and common law jurisdictions across Europe, the Middle East as well as Asia Pacific (where he was the Group General Counsel of a global construction and engineering company for over four years).

Euan has advised different stakeholders on various high-value concession agreements, construction contracts, operation & maintenance contracts and consultant services agreements in respect of a variety of power, utilities, infrastructure, building and development projects. Euan also has significant construction claims and contentious construction experience (including in the form of arbitration, court proceedings, expert determination and mediation/conciliation).

Euan speaks at various construction industry events and regularly publishes topical articles. He is also the secretary of the Abu Dhabi branch of the Lighthouse Club.

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Al Tamimi & Company's leading Construction & Infrastructure practice regularly advises all stakeholders in the construction industry in KSA (and across the GCC) on the following issues:

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Ho Chien Mien

1 Making Construction Projects

1.1 What are the standard types of construction contract in your jurisdiction? Do you have: (i) any contracts which place both design and construction obligations upon contractors; (ii) any forms of design-only contract; and/or (iii) any arrangement known as management contracting, with one main managing contractor and with the construction work done by a series of package contractors? (NB For ease of reference throughout the chapter, we refer to “construction contracts” as an abbreviation for construction and engineering contracts.)

Commonly used standard form construction contracts in Singapore include the Singapore Institute of Architects and Conditions of Building Contract (the “**SIA Conditions**”), the Public Sector Standard Conditions of Contract for Design and Build Conditions of Contract (“**PSSCOC**”), and the Real Estate Developers’ Association of Singapore Design and Build Conditions of Contract (the “**REDAS Conditions**”).

The SIA Conditions are the most widely used standard form for “*construct only*” contracts. Under the REDAS Conditions, the contractor bears both the design and construction responsibilities. On the other hand, the PSSCOC is used for all public projects in Singapore, with different versions catering to both “*construct only*” and “*design and build*” contracts.

FIDIC forms are widely used for engineering projects.

Management contracting is less common in the Singapore construction industry, although this method of procurement is sometimes used by more sophisticated employers.

There are new SIA Conditions which have just been released, which introduce design and build elements. These forms have yet to gain wide acceptance.

1.2 How prevalent is collaborative contracting (e.g. alliance contracting and partnering) in your jurisdiction? To the extent applicable, what forms of collaborative contracts are commonly used?

Whilst there are attempts to introduce collaborative contracting in Singapore, this form of contracting is still in its infancy in Singapore. In this regard, the Singapore government has taken the lead in trying to promote collaborative contracting and has encouraged the use of this form of contracting in the public sector. To this end, the Building Control Authority of Singapore has piloted the introduction of collaborative contracting provisions in selected public sector projects. These will be officially introduced when ready.

1.3 What industry standard forms of construction contract are most commonly used in your jurisdiction?

The most commonly used standard forms of construction contracts are: the PSSCOC forms of contract, mainly for public sector works; the SIA forms of contract; and the REDAS forms of contract. Each of the forms comes in different variants, e.g. lump-sum fixed-price build-only, measurement build-only, lump-sum fixed-price design and build, etc. There is a preference for standard forms which impose both design and build obligations on contractors in Singapore.

1.4 What (if any) legal requirements are there to create a legally binding contract (e.g. in common law jurisdictions, offer, acceptance, consideration and intention to create legal relations are usually required)? Are there any mandatory law requirements which need to be reflected in a construction contract (e.g. provision for adjudication or any need for the contract to be evidenced in writing)?

Construction contracts in Singapore are formed when there is a valid offer and acceptance and valuable consideration is provided. The parties must at a minimum agree on essential particulars such as price, time, and scope of works, in order for the contract to be commercially workable. The parties’ intention to be bound as shown through their words and conduct will also be considered (*Ramo Industries Pte Ltd v DLE Solutions Pte Ltd* [2020] SGHC 4 at [68]).

Within the construction industry, offers are commonly provided by way of tender or bid. Until such an offer is duly accepted, the general position is that no contractual obligation arises.

A construction contract in Singapore does not need to expressly provide for adjudication. The Building and Construction Industry Security of Payment Act (Cap. 30B) (“**SOPA**”), which provides the statutory adjudication scheme in Singapore, applies to any construction or construction-related contracts made in writing on or after 1 April 2005.

1.5 In your jurisdiction please identify whether there is a concept of what is known as a “letter of intent”, in which an employer can give either a legally binding or non-legally binding indication of willingness either to enter into a contract later or to commit itself to meet certain costs to be incurred by the contractor whether or not a full contract is ever concluded.

In Singapore, it is common for employers to instruct their representative or architect to issue a letter of intent to indicate their selection of a contractor. While a letter of intent is normally

stipulated to be non-binding, it gives the contractor a basis upon which to commence the mobilisation of resources and negotiations with subcontractors and suppliers for the project. It also provides contractors with a degree of certainty, particularly where contractors have to place orders for items that require long lead times, such as items to be pre-fabricated in factories before being delivered for assembly on site. Whether a letter of intent is binding would typically depend on its substance, rather than its form.

1.6 Are there any statutory or standard types of insurance which it would be commonplace or compulsory to have in place when carrying out construction work? For example, is there employer's liability insurance for contractors in respect of death and personal injury, or is there a requirement for the contractor to have contractors' all-risk insurance?

In Singapore, parties typically include in construction contracts public liability policies, professional indemnity insurance clauses, or Contractors All Risks Insurance (“CAR”) clauses (which encompass all risks associated with material physical loss or damage in a construction project. Contractors and subcontractors are also required, under the Work Injury Compensation Act (Cap. 354) (“WICA”), to maintain work injury compensation insurance for all employees doing manual work and all non-manual employees earning S\$2,100 a month or less.

1.7 Are there any statutory requirements in relation to construction contracts in terms of: (a) labour (i.e. the legal status of those working on site as employees or as self-employed sub-contractors); (b) tax (payment of income tax of employees); and/or (c) health and safety?

Some examples of such statutory requirements are as follows:

- 1. Generally**, under the Building Control Act (Cap. 29) and the Building Control (Licensing of Builders) Regulations 2008, builders must obtain a builder's licence if the works, broadly speaking, involve the structural integrity of a building. Such works, and/or works located in areas that may have a significant impact on public safety, would typically require the approval of the Commissioner of Building Control. Similarly, a specialist builder's licence is also required to carry out specialist building works.
- 2. Labour:** The Singapore Ministry of Manpower requires foreign unskilled and semi-skilled workers in the construction industry to hold a Work Permit. To qualify for a Work Permit, all foreign workers must obtain a Skill Evaluation Certificate, so as to ensure that they are adequately skilled for various construction trades. Due to quota restrictions on the employment of foreign employees, the ratio of foreign employees to local full-time employees in the employer's total workforce must be limited to 7:1. Employers must also pay a foreign worker levy.
- 3. Tax:** When payments are made to a non-resident company or individual, he/she is required to withhold a percentage of that payment and pay the amount withheld (withholding tax) to the Inland Revenue Authority of Singapore under the Income Tax Act (Cap. 134).
- 4. Health and Safety:** Contractors are required under the WICA to maintain work injury compensation insurance for (i) all employees doing manual work, and (ii) all employees doing non-manual work and earning S\$2,100 a month or less.

1.8 Is the employer legally permitted to retain part of the purchase price for the works as a retention to be released either in whole or in part when: (a) the works are substantially complete; and/or (b) any agreed defects liability period is complete?

Yes. Generally, the standard conditions of contract permit employers to withhold retention monies (typically 5–10% of the contract price), half of which is released upon substantial completion of the works, and the other half is released upon the completion of defects rectification works.

1.9 Is it permissible/common for there to be performance bonds (provided by banks and others) to guarantee the contractor's performance? Are there any restrictions on the nature of such bonds? Are there any grounds on which a call on such bonds may be restrained (e.g. by interim injunction); and, if so, how often is such relief generally granted in your jurisdiction? Would such bonds typically provide for payment on demand (without pre-condition) or only upon default of the contractor?

Contractors are commonly obliged to provide employers with performance bond(s).

In Singapore, there are generally two types – “on-demand” and “conditional” bonds. The employer can only call on a conditional bond upon proof of default, as prescribed in the contract or bond. However, for an on-demand bond, the institution providing the bond has to pay the sum assured on demand by the employer, without any need for proof of default.

The party that procured the bond may attempt to stop the beneficiary's call on an on-demand bond by applying for an injunction. To succeed, the applicant must prove either fraud or unconscionability.

“Unconscionability” is an equitable concept unique to Singapore. It involves an act of unjustifiable unfairness by the party calling on the on-demand bond.

However, parties are free to contractually agree to exclude unconscionability as a basis for stopping a call on the bond, so long as clear language is used to that effect (*CKR Contract Services Pte Ltd v Asplenium Land Pte Ltd & Anor*) [2015] 3 SLR 1041.

In light of the COVID-19 pandemic, the Singapore government implemented the COVID-19 (Temporary Measures) Act 2020 (“COVID-19 TMA”), section 6 of which relates to performance bonds. Generally, when a notification for temporary relief has been served according to sections 5 and 9, a performance bond may not be called upon earlier than seven days before its expiry, until the temporary relief period ends.

1.10 Is it permissible/common for there to be company guarantees provided to guarantee the performance of subsidiary companies? Are there any restrictions on the nature of such guarantees?

There is no impediment to company guarantees being provided to guarantee the performance of subsidiary companies – provided that it can be shown that the provision of such guarantees is in the interest of, and provides a corporate benefit to, the parent company. Such company guarantees are, however, not common. It is more common for a banker's guarantee to be sought. Where corporate guarantees are sometimes seen, is in the sphere of major foreign companies providing a parent company guarantees to guarantee the performance of their subsidiaries in Singapore.

1.11 Is it possible and/or usual for contractors to have retention of title rights in relation to goods and supplies used in the works? Is it permissible for contractors to claim that, until they have been paid, they retain title and the right to remove goods and materials supplied from the site?

The standard form contracts typically vest ownership of goods and supplies used in the works in the employer, whether or not the employer has made payment for those plants or materials. In such cases, as contractors do not have ownership of such goods and supplies, they cannot claim title over such materials in the event of non-payment. However, it should be noted that section 25 of the SOPA allows contractors to place liens over unfixed and unpaid goods supplied by the contractor if the respondent fails to pay the adjudicated amount in full.

2 Supervising Construction Contracts

2.1 Is it common for construction contracts to be supervised on behalf of the employer by a third party (e.g. an engineer)? Does any such third party have a duty to act impartially between the contractor and the employer? If so, what is the nature of such duty (e.g. is it absolute or qualified)? What (if any) recourse does a party to a construction contract have in the event that the third party breaches such duty?

The standard form contracts listed in question 1.1 above contemplate the supervision of works on behalf of the employers by third parties. The REDAS form refers to such a third party as the “Employer’s Representative”, whereas the PSSCOC refers to such a third party as the “Superintending Officer”. Note that it is also not unusual for employers using REDAS and PSSCOC forms to use their own employees as the contract supervisor/administrator. The SIA Conditions stipulate that such a third party has to be an architect.

These third parties (whether independent parties or employees of the employers) are obliged to provide their services in an impartial manner when the contract provides for them to undertake a certifier’s or adjudicator’s role. In all other respects, they act as the employer’s agents, such as when issuing instructions or directions on behalf of the employer, in the best interests of the employer.

2.2 Are employers free to provide in the contract that they will pay the contractor when they, the employer, have themselves been paid; i.e. can the employer include in the contract what is known as a “pay when paid” clause?

No. “Pay when paid” provisions are prohibited by section 9(1) of the SOPA. However, though such provisions are rendered unenforceable, parties would not be absolved of payment obligations owed to the other (*SKK (S) Pte Ltd v Management Corporation Strata Title Plan No 1166* [2013] SGHCR 11 at [23]).

2.3 Are the parties free to agree in advance a fixed sum (known as liquidated damages) which will be paid by the contractor to the employer in the event of particular breaches, e.g. liquidated damages for late completion? If such arrangements are permitted, are there any restrictions on what can be agreed? E.g. does the sum to be paid have to be a genuine pre-estimate of loss, or can the contractor be bound to pay a sum which is wholly unrelated to the amount of financial loss likely to be suffered by the employer? Will the courts in your jurisdiction ever look to revise an agreed rate of liquidated damages; and, if so, in what circumstances?

Yes. A liquidated damages clause will only be enforced if the liquidated damages provided for are genuine pre-estimates of the losses likely to flow from the breach (*Dunlop Pneumatic Tyre Co Ltd v New Garage Motor Ltd* [1915] AC 79 (“*Dunlop Pneumatic*”). That said, reasonable liquidated damages are likely to be recoverable in scenarios where it is not possible to estimate the losses that may be suffered, e.g. public infrastructure projects.

A new test to decide whether or not a liquidated damages provision should be enforced has been laid down by the UK Supreme Court which queries whether the liquidated damages provision is a “secondary obligation”, and if so, whether it “imposes a detriment on a party in breach which is out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation”. However, the traditional test espoused in *Dunlop Pneumatic* is currently still applicable in Singapore, as the new test in *Cavendish* has yet to be considered by Singapore Court of Appeal. It remains to be seen if the Singapore Court of Appeal will adopt the same test as in *Cavendish* in deciding whether or not to enforce a liquidated damages provision.

Finally, Singapore courts have yet to make adjustments to a rate of liquidated damages that has been agreed by the parties.

3 Common Issues on Construction Contracts

3.1 Is the employer entitled to vary the works to be performed under the contract? Is there any limit on that right?

Generally, the employer is entitled to order variations if there is a variation clause in the construction contract. However, the employer usually will not be able to order variations once the certificate of completion has been issued. The contractor is also not required to undertake works beyond the scope of the variation clause itself, which typically defines a variation as any addition, reduction or substitution to the works. Such variations cannot substantially change the nature of the contract.

3.2 Can work be omitted from the contract? If it is omitted, can the employer carry out the omitted work himself or procure a third party to perform it?

Yes. Standard form contracts such as the SIA Conditions and PSSCOC contain clauses that allow an employer to omit works from the contract. However, an employer generally cannot omit works such that the contractor is deprived of the substantial benefit of such works. If the omission has changed the character of the contract substantially, the contractor may allege that the omitted work amounts to a change in the scope and nature of the contract. In practice, however, the employer and contractor may reach a mutual agreement as to the omission of the works.

Subject to the above and any prohibition in the contract, the employer may then carry out the omitted works himself or engage a third party to complete the said works.

3.3 Are there terms which will/can be implied into a construction contract (e.g. a fitness for purpose obligation, or duty to act in good faith)?

Examples of terms that are typically implied under statute include:

1. a contractor’s right to refer payment-related disputes to adjudication (section 12 of the SOPA); or
2. a contractor’s right to suspend performance for non-payment (section 26 of the SOPA).

Terms may also be implied under common law, such as:

1. an employer's obligation to do all that is necessary on his part to bring about completion (*Evergreat Construction Co Pte Ltd v Presscrete Engineering Pte Ltd* [2006] 1 SLR(R) 634 (“*Evergreat*”)); or
2. an employer will not prevent a contractor from performing his obligations under the construction contract (*Evergreat; TT International Ltd v Ho Lee Construction Pte Ltd* [2017] SGHC 62).

3.4 If the contractor is delayed by two concurrent events, one the fault of the contractor and one the fault or risk of his employer, is the contractor entitled to: (a) an extension of time; and/or (b) the costs arising from that concurrent delay?

The position in Singapore with regard to extensions of time for concurrent delays remains unsettled. On this issue, Commonwealth cases are instructive and have persuasive value. In *Henry Boot Construction (UK) Ltd v Malmaison Hotel (Manchester) Ltd* (1999) Con LR 32 (“*Malmaison*”), if there are two concurrent causes of delay, one of which is a relevant event allowing for a time extension and the other is not, the contractor is entitled to an extension of time for the period of delay caused by the relevant event, notwithstanding the concurrent effect of the other. In contrast, the position in the Scottish case of *City Inn Ltd v Shepherd Construction Ltd* [2007] CSOH 190 (“*City Inn*”) is that if there are concurrent causes of delay, the delay should be apportioned as between the relevant event and the contractor's risk events. However, *City Inn* has been rejected in the context of a JCT Standard Form of Building Contract, in the recent case of *Walter Lilly & Co Ltd v Mackay and Another* [2012] EWHC 1773 (TCC), which instead upheld the application of *Malmaison* in England. As such, it is likely that the *Malmaison* approach will be highly persuasive in the Singapore courts. Of note is the local case of *PPG Industries (Singapore) Pte Ltd v Compact Metal Industries Ltd* [2013] SGCA 23, where the Court of Appeal found a concurrent delay and granted an extension of time to the contractor, but without any discussion of any of the above cases.

There is no Singapore authority on the contractor's entitlement to recover prolongation costs occasioned by concurrent delay. That said, a leading author on construction law in Singapore, Chow Kok Fong, notes that where the employer and contractor are responsible for a concurrent delay, the general position of the courts in the UK and the US, as well as the SCL protocol, is that neither party will be able to recover damages from the other party for that period of delay (Chow Kok Fong, *Law and Practice of Construction Contracts* (Sweet & Maxwell Asia, 5th Ed, 2019) pp. 658, 659). However, in practice and by contractual provision, contractors are usually not allowed to claim costs arising out of any extension of time as a result of a concurrent delay.

3.5 Is there a time limit beyond which the parties to a construction contract may no longer bring claims against each other? How long is that period and when does time start to run?

Under the Limitation Act (Cap. 163), the usual limitation period for an action in tort or contract would be six years from the date on which the cause of action accrued. In respect of latent damage, the limitation period is either six years from the date on which the cause of action accrued, or three years from the earliest date on which the claimant first had both (i) the knowledge required for bringing an action for damages in respect of

the relevant damage, and (ii) a right to bring such an action. Note that the law on when a particular cause of action arises is quite complicated – and is dependent also on which cause of action is relied upon – e.g. negligence, breach of contract, breach of statutory duty, etc.

This is, however, subject to a 15-year long-stop limitation.

As a result of the COVID-19 pandemic, where section 5 of the new COVID-19 TMA on temporary relief for inability to perform contracts applies, section 5(7) provides for an extension of the period of limitation for actions relating to an inability to perform contracts.

3.6 Which party usually bears the risk of unforeseen ground conditions under construction contracts in your jurisdiction?

In *Resource Piling Pte Ltd v Geospecs Pte Ltd* [2014] 1 SLR 485, Quentin Loh J stated at [66] that:

“[I]n the context of the Singapore building and construction industry, the risk of adverse subsoil conditions is variably borne by the contractor. None of the standard building contract forms commonly in use in Singapore provide otherwise. This is the well-known and accepted commercial environment of long standing...”

For instance, Clause 5.1 of the PSSCOC states that the risk of unforeseen ground conditions lies with the contractor. However, Clause 5.2 of the PSSCOC allows the contractor to recover additional costs incurred as a result of adverse physical conditions which could not have been reasonably foreseen by an experienced contractor.

3.7 Which party usually bears the risk of a change in law affecting the completion of the works under construction contracts in your jurisdiction?

A change in law is a risk that is typically allocated between the parties using *force majeure* clauses.

There is no clear Singapore authority addressing the issue of which party should bear the risks arising out of a change in law if this is not expressly contemplated by the contract. On the one hand, there is a suggestion that if there is no express provision providing that the happening of such a neutral event would allow the contractor a time extension or a claim in damages, the contractor is taken to have accepted the legal risk of the occurrence of such an event. On the other hand, the Singapore courts may adopt the position expounded by the Supreme Court of Christchurch in *New Zealand Structures & Investments Ltd v McKenzie* [1979] 1 NZLR 515, which held that, in the absence of an express clause as to who should bear responsibility for additional costs occasioned by changes in statutory regulation, it is the responsibility of the employer to vary the work and the contractor is entitled to additional payment for the varied work.

3.8 Which party usually owns the intellectual property in relation to the design and operation of the property?

Generally, the creator of a piece of work owns the copyright of that work. However, where the work was created by the person in the course of his employment, the employer would generally be the owner of the copyright in that work. Therefore, technical or commercial information created by the architects or engineers of the employer would usually belong to the employer. Usually, this is dealt with in the contract provisions.

3.9 Is the contractor ever entitled to suspend works?

Yes. A contractor may suspend work if the contract confers on the contractor a right to do so. Typically, contracts may permit suspension on account of:

1. a serious breach (typically in relation to certification and payment terms of the contract) by the employer; and
2. the architect's failure to issue a certificate, save for an interim certificate (e.g. Clause 33(4) of the SIA Conditions). Separately, sections 23 and 26 of the SOPA entitle a contractor to stop work in the event of the employer's failure to pay an adjudicated amount following the rendering of an adjudication determination in the contractor's favour.

Otherwise, there is no common law right to suspend work (*I-Lab Engineering Pte Ltd v Shriro (Singapore) Pte Ltd* [2018] SGHCR 15; *Jia Min Building Construction Pte Ltd v Ann Lee Pte Ltd* [2004] 3 SLR(R) 288 ("*Jia Min*").

Where legislation or the government requires – such as the COVID-19 circuit breaker measures suspending all non-essential activities at workplace premises – contractors must suspend works.

3.10 Are there any grounds which automatically or usually entitle a party to terminate the contract? Are there any legal requirements as to how the terminating party's grounds for termination must be set out (e.g. in a termination notice)?

In addition to any express grounds for termination in a contract, the usual grounds on which an innocent party is entitled to terminate a contract include (i) such party's common law rights to terminate for the other party's repudiation of performance (or abandonment), (ii) where there is a breach of a condition, or (iii) where the breach in question deprives the innocent party of substantially the whole benefit of the contract, save where the term expressly, clearly and unambiguously states that any breach of it, regardless of the seriousness of the consequences to follow, would never entitle the innocent party to terminate the contract (*RDC Concrete Pte Ltd v Sato Kogyo (S) Pte Ltd* [2007] 4 SLR(R) 413; *Sports Connection Pte Ltd v Deuter Sports GmbH* [2009] 3 SLR(R) 883).

3.11 Do construction contracts in your jurisdiction commonly provide that the employer can terminate at any time and for any reason? If so, would an employer exercising that right need to pay the contractor's profit on the part of the works that remains unperformed as at termination?

The standard form construction contracts in Singapore do not provide for the employer to have the right to terminate at any time and for any reason. Nevertheless, it is not uncommon for some employers to try to incorporate such a provision in their contracts. Where such provisions are incorporated, and unless there is an express provision providing that the employer exercising such a right need not pay the contractor's profit on the part of the works that remains unperformed as at termination, it is arguable that such profits may be recoverable by the contractor. Although the termination at any time and for any reason would not be in breach of contract, it would be arguable that an implied term exists to require the employer exercising such a right to pay the contractor's profit on the part of the works that remains unperformed as at termination. Such an

argument would nevertheless be very fact-dependent – particularly on the terms of the construction contract concerned.

3.12 Is the concept of *force majeure* or frustration known in your jurisdiction? What remedy does this give the affected party? Is it usual/possible to argue successfully that a contract which has become uneconomic is grounds for a claim for *force majeure*?

The concepts of *force majeure* and frustration are known in Singapore.

Parties may contractually provide for non-performance upon the occurrence of specified *force majeure* events so that such non-performance does not amount to a breach. Whether *force majeure* arises and what rights and obligations follow such an event is subject to a precise construction of the contractual clause itself.

In the absence of a *force majeure* clause, the common law doctrine of frustration may excuse the non-performance of a contractor by treating the contract as having existed until the point when the frustrating event occurred, while any accrued rights and obligations remain enforceable after the frustrating event. However, the doctrine of frustration operates only in exceptional circumstances, where the supervening event is one that radically or fundamentally alters the contract such that it is no longer the same as what was originally entered into.

3.13 Are parties, who are not parties to the contract, entitled to claim the benefit of any contractual right which is made for their benefit? E.g. is the second or subsequent owner of a building able to claim against the contractor pursuant to the original construction contracts in relation to defects in the building?

Section 2 of the Contracts (Rights of Third Parties) Act (Cap. 53B) allows a third party to benefit under the contract if (i) the contract expressly states the same, or (ii) the contract purports to confer a benefit on him and the parties intended that the term would be enforceable by the third party.

3.14 On construction and engineering projects in your jurisdiction, how common is the use of direct agreements or collateral warranties (i.e. agreements between the contractor and parties other than the employer with an interest in the project, e.g. funders, other stakeholders, and forward purchasers)?

The use of collateral warranties appears to be more common than direct agreements, especially as between funders and contractors. Even then, where there are step-in rights for funders, collateral warranties are not always insisted upon.

3.15 Can one party (P1) to a construction contract, who owes money to the other (P2), set off against the sums due to P2 the sums P2 owes to P1? Are there any limits on the rights of set-off?

Under Singapore law, in addition to any rights conferred by the contract, P1 may rely on legal and equitable set-off to set off against the sums due to P2 the sums P2 owes to P1. However, both legal and equitable rights of set-off can be excluded by clear and unequivocal words in a contract (*Jia Min*). Contracts providing for temporary finality on the architect's certificates may also exclude set-offs which have not been certified by the architect (*Chin Ivan v H P Construction & Engineering Pte Ltd* [2015] 3 SLR 124).

At common law, the amount should be ascertainable and due, while in equity, the right of set-off includes unliquidated damages. However, unlike legal set-off, equitable set-off needs to be inseparably connected to the claim against which it is raised.

3.16 Do parties to construction contracts owe a duty of care to each other either in contract or under any other legal doctrine? If the duty of care is extra-contractual, can such duty exist concurrently with any contractual obligations and liabilities?

Parties to construction contracts can owe a duty of care to each other in contract, with such scope and content as contractually prescribed. At the same time, a concurrent duty of care in tort may also arise if the test laid down in *Spandeck Engineering (S) Pte Ltd v Defence Science & Technology Agency* [2007] 4 SLR(R) 100 is satisfied:

1. it must be factually foreseeable that a failure by one party to take reasonable care could result in the other party suffering damages;
2. there must be sufficient legal proximity between the parties, taking into account the physical, circumstantial, and causal proximity of the parties and their acts; and
3. there must be no policy considerations which would militate against the establishment of a tortious duty of care.

This tortious duty of care cannot be inconsistent with the terms of the contract.

3.17 Where the terms of a construction contract are ambiguous, are there rules which will settle how that ambiguity is interpreted?

The current approach taken by Singapore courts for the construction of contract terms is a “contextual” one (*Zurich Insurance (Singapore) Pte Ltd v B-Gold Interior Design & Construction Pte Ltd* [2008] 3 SLR(R) 1029 (“*Zurich*”). Under this approach, the court takes into account the “essence and attributes of the document being examined” (*Zurich* at [132(a)]).

Extrinsic evidence may be admitted to aid in the interpretation of the written words of a contract, provided that the extrinsic evidence in question is “relevant, reasonably available to all the contract parties and relates to a clear or obvious context” (*Zurich* at [132(d)]).

If there is still any ambiguity in the interpretation of a clause, the *contra proferentem* rule would apply and the clause is to be construed against the party seeking to rely on it.

3.18 Are there any terms which, if included in a construction contract, would be unenforceable?

The following are examples of unenforceable terms/clauses in a contract:

1. clauses which exclude liability for personal injury or death (section 2 of the Unfair Contract Terms Act (Cap. 396));
2. “pay when paid” provisions (section 9 of the SOPA);
3. liquidated damages clauses that amount to a penalty; and
4. provisions which might prevent, modify, restrict, or otherwise prejudice the operation of the terms of the SOPA (section 36(2) of the SOPA). In determining if a contractual clause offends section 36(2) of the SOPA, a balance must be struck between protecting the entitlement of those performing the work to receive progress payments, and the parties’ freedom to contract (*CHL Construction Pte Ltd v Yangguang Group Pte Ltd* [2019] SGHC 62 at [32]).

3.19 Where the construction contract involves an element of design and/or the contract is one for design only, are the designer’s obligations absolute or are there limits on the extent of his liability? In particular, does the designer have to give an absolute guarantee in respect of his work?

Usually, an architect’s liability is not absolute in the sense that the architect is liable wholly for all losses that result from the acts of that architect. It must be shown that the architect has fallen short of the standard of the ordinary skilled person exercising and professing to have a special skill or competence (*Bolam v Friern Hospital Management Committee* [1957] 1 W.L.R. 582 at 586). In certain circumstances, an architect may also rely on the independent contractor defence (*MCST 3322 v Mer Vue Developments Pte Ltd* [2016] 2 SLR 793).

In special circumstances, an architect can enter into a duty beyond that of using skill and care in carrying out design. This may occur expressly (for instance, by contract) or it may be implied that the designer has warranted the achievement of a certain result, e.g. a fitness for purpose clause.

Employers may, in practice, try to extract an absolute guarantee from designers in respect of their work. However, designers seldom agree to this due to difficulties in obtaining professional indemnity insurance in this regard.

3.20 Does the concept of decennial liability apply in your jurisdiction? If so, what is the nature of such liability and what is the scope of its application?

No, the concept of decennial liability does not apply in Singapore.

4 Dispute Resolution

4.1 How are construction disputes generally resolved?

Apart from litigation, the SOPA provides for an adjudication process to achieve a fast and low-cost settlement of payment disputes. Disputes are also commonly resolved through arbitration. The SIA Conditions and PSSCOC both provide for this avenue of dispute resolution. Parties may also need to proceed to mediation before the commencement of arbitration or litigation proceedings. Alternatively, arbitration or litigation proceedings may be stayed in order for parties to pursue mediation. The Singapore government has recently started to promote collaborative contracting which may involve the use of standing dispute adjudication boards to help resolve disputes. The new COVID-19 TMA also provides for determination before an assessor in relation to disputes regarding temporary relief from inability to perform contracts caused by a COVID-19 event.

4.2 Do you have adjudication processes in your jurisdiction (whether statutory or otherwise) or any other forms of interim dispute resolution (e.g. a dispute review board)? If so, please describe the general procedures.

Yes, there is a mandatory statutory adjudication procedure under the SOPA applicable to most types of construction works. An adjudication typically occurs in the following manner:

1. The contractor may activate the adjudication process by serving a payment claim on the employer.
2. The employer is required to provide a payment response stating, amongst other things, the response amount and, if

the response amount is less than the claimed amount, the reason for the difference and the reason for any amount withheld.

3. If the contractor to a construction contract disputes the payment response issued by the employer, or if the employer failed to provide a payment response within the period stipulated by the SOPA, the contractor is entitled to make an adjudication application after a stipulated period.
4. After the contractor lodges the adjudication application, the employer shall lodge an adjudication response, following which the adjudicator shall make a determination.

The adjudication process is designed to determine the quantum of payment quickly and economically without the full length of arbitration or litigation. Typically, the adjudication process can be completed within a few weeks.

4.3 Do the construction contracts in your jurisdiction commonly have arbitration clauses? If so, please explain how, in general terms, arbitration works in your jurisdiction.

Yes. The SIA Conditions, PSSCOC and REDAS Conditions contain arbitration clauses.

A dual arbitration regime exists in Singapore. Domestic arbitrations are governed by the Arbitration Act (Cap. 10) (“AA”) and international arbitrations are governed by the International Arbitration Act (Cap. 143A) (“IAA”). Many provisions in the two statutes are similar. Nonetheless, the main distinctions are as follows:

- **Stay of court proceeding in favour of arbitration**
Under the domestic arbitration regime, the court has discretionary power as to whether to grant a stay where one of the parties commenced court proceedings in contravention of an arbitration agreement. However, under the international arbitration regime, it is mandatory for a court to grant a stay if the court is satisfied that there is an arbitration agreement, unless such an agreement is null and void, inoperative or incapable of being performed.
- **Appeal against an award**
Under the domestic arbitration regime, a party who is dissatisfied with an arbitral award may appeal to the court. This right to appeal is limited to questions of law arising out of an award made in the proceeding. Under the international arbitration regime, there is no right of appeal at all.

4.4 Where the contract provides for international arbitration, do your jurisdiction’s courts recognise and enforce international arbitration awards? Please advise of any obstacles (legal or practical) to enforcement.

Yes. Singapore is a signatory to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. Thus, an international arbitration award may be enforced, with leave of court, in the same manner as a judgment or an order of the court (i) by an action under common law, (ii) under section 29 of the IAA, or (iii) under section 46(3) of the AA.

The Rules of Court set out the procedures for enforcing a foreign arbitral award. Generally, an application can be made by filing an originating summons, which is supported by an affidavit. Once leave is given by the court to enter judgment on an application to enforce the award, the other party has 14 days to challenge the leave granted.

Enforcement of international arbitration awards from arbitrations seated in Singapore may be refused on either the grounds set out in Article 34 of the UNCITRAL Model Law

on International Commercial Arbitration, or section 24 of the IAA (*PT First Media TBK v Astro Nusantara International BV* [2014] 1 SLR 372). Enforcement of all other foreign awards may only be refused on the grounds set out under section 31 of the IAA.

4.5 Where a contract provides for court proceedings in your jurisdiction, please outline the process adopted, any rights of appeal and a general assessment of how long proceedings are likely to take to reduce: (a) a decision by the court of first jurisdiction; and (b) a decision by the final court of appeal.

An action is commenced with the claimant’s personal service of a copy of a writ or any other originating process (supported by a statement of claim or affidavit, respectively) on the defendant within six months of its issue by the court, or within 12 months if the claim is to be served out of jurisdiction. Once pleadings are exchanged, discovery, the exchange of affidavits of evidence-in-chief and expert reports (if necessary) and setting down for trial occur. A party may file an appeal within one month of the rendering of the judgment.

Typically, as construction disputes involve large volumes of evidence and require the provision of expert evidence, the time required to resolve such disputes may vary between 12 and 24 months.

4.6 Where the contract provides for court proceedings in a foreign country, will the judgment of that foreign court be upheld and enforced in your jurisdiction? If the answer depends on the foreign country in question, are there any foreign countries in respect of which enforcement is more straightforward (whether as a result of international treaties or otherwise)?

Generally, yes. Foreign judgments may be enforced in Singapore under the:

1. Reciprocal Enforcement of Commonwealth Judgments Act (Cap. 264) (“RECJA”): Facilitates the enforcement of judgments or orders of superior courts of the Commonwealth countries whereby a sum of money is made payable.
2. Reciprocal Enforcement of Foreign Judgments Act (Cap. 265) (“REFJA”): Facilitates the enforcement of judgments by courts of non-Commonwealth countries which have been gazetted under the REFJA. The judgment need not be monetary.
3. Common law: Facilitates the enforcement of foreign judgments which fall outside the ambit of RECJA and REFJA.

However, do note that the Reciprocal Enforcement of Commonwealth Judgments (Repeal) Act 2019 (“RECJA Repeal Act”) has been passed though it has not yet come into force, and REFJA was amended through the Reciprocal Enforcement of Foreign Judgments (Amendment) Act 2019 (“REFJ(A)A”). These Acts aim to consolidate Singapore’s statutory regime on the enforcement of foreign judgments into a single framework, and expand the scope of reciprocal arrangements regarding enforcement of foreign judgments with other countries.

Under the common law, an *in personam* final and conclusive foreign judgment rendered by a court of competent jurisdiction, which is also a judgment for a definite sum of money, is enforceable in Singapore provided, *inter alia*:

1. it was not procured by fraud;
2. its enforcement would not be contrary to public policy;
3. its enforcement would not be an enforcement of foreign penal, revenue or other public laws; or
4. the proceedings in which it was obtained were not contrary to natural justice.



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1 Making Construction Projects

1.1 What are the standard types of construction contract in your jurisdiction? Do you have: (i) any contracts which place both design and construction obligations upon contractors; (ii) any forms of design-only contract; and/or (iii) any arrangement known as management contracting, with one main managing contractor and with the construction work done by a series of package contractors? (NB For ease of reference throughout the chapter, we refer to "construction contracts" as an abbreviation for construction and engineering contracts.)

In the Republic of Slovenia, construction contracts are concluded in accordance with the provisions of the Obligations Code (OZ), Special Construction Usages (PGU) and the International Federation of Consulting Engineers' (FIDIC) books.

As per the OZ, a construction contract (and a building contract) is a contract for work through which the contractor undertakes to build a specific structure on specific land according to a specific plan by a specific deadline, or to carry out any other construction work on such land or on an existing structure, and the employer undertakes to pay the contractor a specific fee for the work. The law also stipulates that this contract must be concluded in writing.

The execution of particular construction work is usually not just about concluding a single contract. Construction works require preparation, which is done by the employer himself or by a third party hired for this work. Namely, the contractor who will carry out the construction needs plans on which to base the work that will be completed. Typically, in addition to the building contract, two contracts are concluded in this connection; namely, the project construction contract (design contract) and the construction control contract (supervising construction contract), but those two are explicitly regulated by the OZ.

The design contract is subject to the rules of contracts for work. It is an independent contract concluded by the employer and the contractor of the project.

Apart from the above, the parties are free to agree on any other form or mixed forms of contract. Thus, different types of contract can be concluded: construction and design contracts; design-only contracts; or programme management contracts, etc.

1.2 How prevalent is collaborative contracting (e.g. alliance contracting and partnering) in your jurisdiction? To the extent applicable, what forms of collaborative contracts are commonly used?

In the jurisdiction of Slovenia, collaborative contracting is not very common. Usually, the employer and contractor conclude

the contractual contract and then the contractor concludes separate contracts with sub-contractors.

However, in public procurement procedures in Slovenia the contractors often appear in a consortium. Another form of co-operation between contractors is a joint venture entity, which is less common.

1.3 What industry standard forms of construction contract are most commonly used in your jurisdiction?

There are not really any standard forms specific to a certain industry. The OZ has some specific provisions about the construction contracts that are most commonly used in all industries. Usually, the PGU is also used to complement the OZ provisions and agreements made by parties. Other standard forms, such as FIDIC books, are used quite rarely (mainly for large-scale projects, or public procurement contracts in the case of co-financing of construction projects by the European Union).

1.4 What (if any) legal requirements are there to create a legally binding contract (e.g. in common law jurisdictions, offer, acceptance, consideration and intention to create legal relations are usually required)? Are there any mandatory law requirements which need to be reflected in a construction contract (e.g. provision for adjudication or any need for the contract to be evidenced in writing)?

The general legal requirement in the Slovenian OZ is that a legally binding contract shall be deemed concluded when the contracting parties agree upon its essence or, in other words, agree upon essential elements of the contract. Therefore, the essential elements of a construction contract, especially the scope of the works and the payment, must be agreed between the parties of the construction contract.

Regarding special mandatory law requirements, construction contracts must be concluded in written form. The contract may also be concluded through written offer and written acceptance of this offer.

1.5 In your jurisdiction please identify whether there is a concept of what is known as a "letter of intent", in which an employer can give either a legally binding or non-legally binding indication of willingness either to enter into a contract later or to commit itself to meet certain costs to be incurred by the contractor whether or not a full contract is ever concluded.

The short answer is yes.

In concluding transactions, a letter of intent is increasingly used in practice by parties in the process of negotiation regarding all the components of the transaction. Often, in the later stages of a transaction, especially when one of the parties is not ready to conclude a contract, the question arises as to what the legal nature of the letter of intent is and how strongly it binds the parties who sign such letter of intent.

The letter of intent is a notion that is not known or regulated by the OZ. It has been developed by business practices regarding the contracting phase, especially for cases where negotiations are lengthy and more complex transactions are involved.

The letter of intent is a written statement from one or both parties during the negotiations or at the end of the negotiations. Although the purpose of a letter of intent is to identify and explain to the parties what the stage of contracting is and what their mutual rights and obligations are, there are often disputes as to whether the parties really agreed on a particular right or obligation. Not all letters of intent can be defined on the same legal grounds, since this requires analysis of each specific case to determine the legal nature or legal consequences of a specific letter of intent. An individual letter of intent may have the legal nature of an offer or even express consent to the instructions and therefore constitute a contract.

Therefore, a signed document addressed to the parties as a letter of intent may, in substance, constitute a number of different documents – it may be a letter of intent by which the parties do not commit themselves and merely outline what their purposes and objectives are in relation to a potential transaction, and how the transaction process will proceed in the future. Alternatively, the document may, through its content, constitute a precontract or a contract, if all the necessary components have been agreed.

1.6 Are there any statutory or standard types of insurance which it would be commonplace or compulsory to have in place when carrying out construction work? For example, is there employer's liability insurance for contractors in respect of death and personal injury, or is there a requirement for the contractor to have contractors' all-risk insurance?

In accordance with the Slovenian jurisdiction, the statutory insurance which is compulsory for contractors is business liability insurance. Contractors are also obliged to register their own employees for the compulsory social insurance (health insurance, pension and disability insurance, parental insurance, and unemployment insurance).

1.7 Are there any statutory requirements in relation to construction contracts in terms of: (a) labour (i.e. the legal status of those working on site as employees or as self-employed sub-contractors); (b) tax (payment of income tax of employees); and/or (c) health and safety?

There are no specific statutory requirements in relation to construction contracts in terms of labour, social security, tax and health and safety. All general laws related to those areas are also applicable to any staff member working on the project site. The legal status of those people depends on their agreement with the employer; however, if a self-employed worker essentially only works for one employer, the court could establish that such person is treated as an employee by that employer. For foreign workers, work permits might be required.

1.8 Is the employer legally permitted to retain part of the purchase price for the works as a retention to be released either in whole or in part when: (a) the works are substantially complete; and/or (b) any agreed defects liability period is complete?

Yes. Usually the payment from the employer to the contractor, based on the construction contract, is made upon final takeover in full or (more typically) in instalments. Upon such payment, the employer may retain part of the purchase price for the works as a retention, if agreed by both parties. Both options (a) and (b) are possible. Such retention can also be made under the PGU provisions unless parties excluded their use in the contract. The PGU stipulates that the employer has the right to retain a proportionate part of the price to remedy the deficiencies found at the time of acceptance and delivery of the works.

1.9 Is it permissible/common for there to be performance bonds (provided by banks and others) to guarantee the contractor's performance? Are there any restrictions on the nature of such bonds? Are there any grounds on which a call on such bonds may be restrained (e.g. by interim injunction); and, if so, how often is such relief generally granted in your jurisdiction? Would such bonds typically provide for payment on demand (without pre-condition) or only upon default of the contractor?

In Slovenia, bank guarantees are permissible and quite common (especially in public procurement contracts). We can divide bank guarantees into two basic forms: 1. independent ("on first demand") bank guarantee (typical); and 2. dependent bank guarantee (rare). Bank guarantee "on first demand" essentially means that the contractor's bank must pay the requested sum to the employer immediately when the employer calls on the guarantee. This bank guarantee is independent from the basic contract. There are no statutory restrictions on the nature of such bank guarantees. In the construction industry, the two most common types of bonds are: performance bond for the time period between signing of the contract and takeover; and warranty bond for the time period between takeover and the end of the contractor's liability. Typically, there are no restrictions on the agreed percentage of the performance and warranty bond. However, the Decree on financial collateral in public procurement, in relation to the Public Procurement Act, states that the maximum allowed percentage for a performance bond is 10% and for a warranty bond is 10% of the purchase price (with VAT).

Regarding the grounds on which a call on such bonds may be restrained (e.g. by interim injunction), it is possible for the court to bring an interim injunction to stop the bank paying the amount referred to in a bond. The Execution and Security Act stipulates that a court will issue an interim injunction to secure a non-monetary claim if the creditor proves it is likely that the claim exists or that the claim against the debtor will arise. The creditor must also make one of the following assumptions:

- that there is a risk that the enforcement of the claim will be precluded or substantially impaired;
- that the injunction is necessary to prevent the use of force or the occurrence of damage that is difficult to recover; or
- that if the provisional injunction was rendered unfounded in the course of the proceedings, the debtor would not suffer more serious adverse consequences than those which would have occurred without the issuance of the provisional injunction.

The creditor is not obliged to prove the risk if it is likely that the debtor with the proposed order would suffer only minor damage. A risk is considered to be apparent if the claim is to be made abroad, unless the claim is made in a Member State of the European Union.

Case law shows that courts are hesitant in issuing interim injunctions; in other words, interpretation of provisions on interim injunctions are restrictive.

1.10 Is it permissible/common for there to be company guarantees provided to guarantee the performance of subsidiary companies? Are there any restrictions on the nature of such guarantees?

It is permissible, but company guarantees are not very common in Slovenia. Company guarantees are not specifically regulated under Slovenian law. In business practice, it is possible to issue parent company guarantees. In practice, it is also often agreed between contractors and subcontractors that the contractor is responsible for the defects of the subcontractor, as if they were caused by the contractor himself. Such clause is also stated in Sub-Clause 4.4 FIDIC Red Book, which deals with breaches by the subcontractor of the subcontract which cause damage to the contractor under the main contract.

1.11 Is it possible and/or usual for contractors to have retention of title rights in relation to goods and supplies used in the works? Is it permissible for contractors to claim that, until they have been paid, they retain title and the right to remove goods and materials supplied from the site?

It is possible for contractors to have retention of title rights in relation to goods and supplies used in the works and, on the grounds of such clause and non-payment, claim removal of goods and supplies. It can be agreed that there will be transfer of title upon payment. However, as soon as goods have been installed or become part of the building, the title will transfer automatically to the owner of the development (under the Law of Property Code).

2 Supervising Construction Contracts

2.1 Is it common for construction contracts to be supervised on behalf of the employer by a third party (e.g. an engineer)? Does any such third party have a duty to act impartially between the contractor and the employer? If so, what is the nature of such duty (e.g. is it absolute or qualified)? What (if any) recourse does a party to a construction contract have in the event that the third party breaches such duty?

Yes, it is usually mandatory for construction contracts to be supervised, on behalf of the employer, by a third party (supervising engineer).

A supervising construction contract is a contract intended for a third party to control the progress of the work, the consumption of material, the amount of work performed, or the work being carried out in accordance with the project documentation, etc. In practice, such contracts have become established as an independent contract type, which is not subordinated to a construction or works contract, but is subject to the rules of a contract of mandate. Unlike construction contracts and contracts for works, which are success contracts, a construction control contract is an endeavour, so the contractor must make sure that he controls the construction with due care.

The scope of supervision is defined primarily in the Building Act and in the Architecture and Civil Engineering Act. Apart from that, parties can freely agree on the scope.

A supervising engineer acts on behalf of the employer but is obliged to follow statutory obligations.

Usually, there is no recourse by the construction contract party in the event of a third-party breach of the other contract. Nevertheless, such recourse could be allowed contractually, so that the contract is to the benefit of a third party.

2.2 Are employers free to provide in the contract that they will pay the contractor when they, the employer, have themselves been paid; i.e. can the employer include in the contract what is known as a “pay when paid” clause?

The “pay when paid” clause is very rare in contractual contracts in Slovenia. However, the employer and contractor are free to agree on such clause in a contractual contract.

A more common example is the agreement between contractor and subcontractor stating that the contractor will not pay the subcontractor unless or until the employer pays the contractor.

In case of a dispute regarding a “pay when paid” clause, the court would probably decide that this clause is invalid because it is not consistent with the basic principle of conscientiousness and fairness.

2.3 Are the parties free to agree in advance a fixed sum (known as liquidated damages) which will be paid by the contractor to the employer in the event of particular breaches, e.g. liquidated damages for late completion? If such arrangements are permitted, are there any restrictions on what can be agreed? E.g. does the sum to be paid have to be a genuine pre-estimate of loss, or can the contractor be bound to pay a sum which is wholly unrelated to the amount of financial loss likely to be suffered by the employer? Will the courts in your jurisdiction ever look to revise an agreed rate of liquidated damages; and, if so, in what circumstances?

There are two different notions in Slovenia: liquidated damages and contractual penalties.

The contracting parties may, by agreement, modify the statutory regime for damages for breach of contract. The parties may also agree on a contractual penalty (for non-monetary liabilities) or pre-determine the amount of compensation (flat-rate compensation), thereby reinforcing the debtor’s obligation.

Given the above, contractual penalty should be distinguished from liquidated damages. In the case of a contractual penalty, the creditor must prove a breach of a contractual obligation under the responsibility of the counterparty, and neither the existence nor the amount of the damage should be proved, since this is not a prerequisite for the right to a contractual penalty.

In the event of a claim for damages, the existence of damage is always a condition for the success of the claim, and in addition to the breach of contractual obligation (for which the debtor is responsible), a causal link must be made between breach of contractual obligation and damage suffered by the loyal customer contract. It is not entirely clear whether liquidated damages require proof of breach of contract (for which the debtor is responsible), damages and a causal link between breach of contractual obligation and damage. Undoubtedly, the creditor does not have to prove the amount of the damage, but also – with regard to the remaining assumptions of a business compensation obligation – the burden of proof is shifted to the debtor. The purpose of a liquidated damages agreement

is to avoid proving the amount of the damages. The liquidated damages agreement is therefore in favour of a loyal party, so it is also reasonable to take the view that it can also succeed in claiming full compensation (if greater than the agreed liquidated damages) if it succeeds in proving all the assumptions of a business compensation obligation. Applying the third paragraph of Article 242 of the OZ (or Article 252 of the OZ), the claim for reduction of the amount of liquidated damages should be granted to the party breaching the contract if damages are manifestly disproportionate to the damage. This can only occur in this exceptional case, otherwise 'liquidated damages' would lose its meaning.

3 Common Issues on Construction Contracts

3.1 Is the employer entitled to vary the works to be performed under the contract? Is there any limit on that right?

The employer is entitled to vary the works to be performed under the construction contract. According to Article 3 of the Slovenian OZ, participants shall be free to regulate their obligational relationships.

According to the PGU, the employer is entitled to vary the technical documentation, which is the basis of performing works.

If the technical documentation is changed, the contract price, timeline and other parts of the contract will also be changed appropriately.

The contractor has the right to request changes to be put in the contract or to terminate the contract, if the conditions for performing the contract are altered significantly due to the change of technical documentation.

However, this principle does not apply to public procurement law, where the parties' autonomy is limited. In accordance with the Slovenian Public Procurement Act, contracts and framework agreements may only be modified without a new procurement procedure in certain cases.

3.2 Can work be omitted from the contract? If it is omitted, can the employer carry out the omitted work himself or procure a third party to perform it?

The contractor shall be obliged to execute the work according to the agreement and according to the rules of the transaction. The contractor must execute the work by the deadline stipulated, or in the time reasonably required for such transactions if no deadline is stipulated. The contractor may not omit any work from the contract, unless omission is agreed with the employer. Omission of work, without consent of the employer, is considered a breach of contract.

The contract may also not give the employer the right to omit part of the work from the contract. In case of omission of the work by the employer, the contractor is still entitled to the full compensation, reduced by the expenses saved.

Generally, a work in a contract cannot be omitted for the purpose of assigning work to another contractor unless otherwise agreed between the parties. The contractor shall be entitled to perform all the contract work. In normal circumstances, the act of omission and assigning it to another contractor is considered bad practice and contrary to the principle of good faith in the construction industry.

3.3 Are there terms which will/can be implied into a construction contract (e.g. a fitness for purpose obligation, or duty to act in good faith)?

The basic principles of the Slovenian OZ, e.g. the principles of conscientiousness and fairness, the duty to act in good faith, diligence, prohibition on abuse of rights, duty to perform obligations, and prohibition on infliction of damage, shall also apply to construction contracts.

The term 'fitness for purpose' shall not apply in construction contracts. Contractors shall deliver what they have bargained for, and employers shall not expect contractors to guess what their future intentions might be.

3.4 If the contractor is delayed by two concurrent events, one the fault of the contractor and one the fault or risk of his employer, is the contractor entitled to: (a) an extension of time; and/or (b) the costs arising from that concurrent delay?

In Slovenian law, such a case would be regulated by the fundamental principles of the OZ, such as the rule of simultaneous performance, which determines that in bilateral contracts neither party shall be obliged to perform its own obligations if the other party is not simultaneously performing the latter's obligations or is unwilling to do so, unless agreed otherwise or stipulated otherwise by law, or unless it follows otherwise from the nature of the transaction.

Taking this into account, the contractor would be entitled to an extension of time and the remuneration of costs arising from that concurrent delay, corresponding to the fault of his employer.

3.5 Is there a time limit beyond which the parties to a construction contract may no longer bring claims against each other? How long is that period and when does time start to run?

Regarding the liability of the contractor and designer for solidity of structure of the building, the time limit to bring claims between the parties is as follows:

The contractor shall be liable for any defects in the execution of the structure concerning its solidity if such defects show themselves within 10 years of the delivery and takeover of the works.

The contractor shall also be liable for any deficiencies in the land on which the structure is built that show themselves within 10 years of the delivery and takeover of the works, unless a specialist organisation gave an expert opinion that the land was suitable for construction and during construction no circumstances arose to awaken any doubt over the justification of the expert opinion.

This shall also apply to the designer, if the defect in the structure originates from any defect in the plan.

Under these provisions, the contractor or designer shall be liable not only to the ordering party, but also to any other acquirer of the structure. It shall not be possible to exclude or limit their liabilities by contract.

The employer shall be obliged to notify the contractor and designer regarding defects within six months of discovering the defect; otherwise, the ordering party or acquirer shall lose the right to make reference thereto.

The right of the ordering party or other acquirer against the contractor or designer, deriving from their liability for defects, shall expire one year after the day the contractor or designer was notified regarding the defect.

The contractor or designer may not make reference to the provisions above if the defect relates to facts that were known or could not have remained unknown thereto and that they failed report to the ordering party or other acquirer, or if through their action they misled the ordering party or other acquirer into failing to exercise the rights on time.

Regarding the construction of something other than a building, the time limit to bring claims between the parties is as follows:

Two years from takeover of works. In this case, the employer shall be obliged to notify the contractor as soon as possible, but at least within a month of the defect being discovered, if the defect has not been noticed during a customary inspection. An employer who notified the contractor on time regarding defects in an executed work may no longer exercise rights in court proceedings one year after such notification.

Regarding performing work before takeover or payment, the time limit to bring claims between the parties is as follows:

Three years in commercial contracts (contracts concluded by commercial entities among themselves), or five years in other contracts (general statute-barring period).

In case of a claim for performance, the limitation period starts when the contractor does not accomplish the work or stops the work without being entitled to do so. The limitation period for payment claims starts when payment is due.

3.6 Which party usually bears the risk of unforeseen ground conditions under construction contracts in your jurisdiction?

The Slovenian OZ does not regulate which party shall bear the risk of unforeseen ground conditions under construction contracts. However, in practice, usually the employer carries the risk of unforeseen ground conditions, unless otherwise agreed between the parties.

Regardless, the Slovenian OZ regulates the matter of urgent unforeseen works, which may be the consequence of unforeseen ground conditions. In such cases, the contractor may carry out urgent unforeseen works without the employer's prior approval if the approval cannot be supplied because of the urgency of the works. Unforeseen works are those that have to be performed urgently to ensure the stability of the structure or to prevent the occurrence of damage, and that were caused by the unexpectedly heavy nature of the land, unexpected water or any other extraordinary, unexpected development. The contractor must notify the employer without delay regarding such circumstance and the measures taken. The contractor shall have the right to fair payment for the unforeseen works it was necessary to perform.

The employer may withdraw from the contract if the agreed fee would be considerably higher owing to such works. In the event of withdrawal from the contract, the employer must pay the contractor an appropriate part of the fee for the work already performed, and a fair reimbursement of the necessary costs.

3.7 Which party usually bears the risk of a change in law affecting the completion of the works under construction contracts in your jurisdiction?

The Slovenian OZ does not regulate which party usually bears the risk of a change in law affecting the completion of the works under construction contracts. However, in practice the

employer would usually bear the risk of a change in law, unless otherwise agreed between the parties.

3.8 Which party usually owns the intellectual property in relation to the design and operation of the property?

In general, the rights to intellectual property belong to the person who created the design.

Under Slovenian law, a design needs to be registered in order to be protected under industrial property law as a patent or industrial design.

Patents shall be granted for any inventions, in all fields of technology, which are new, involve an inventive step and are susceptible to industrial application.

An industrial design shall be registered as a design to the extent that it is new and has an individual character.

3.9 Is the contractor ever entitled to suspend works?

The contractor shall have the right to suspend the execution of the works if he is unable to perform the works due to the employer's conduct or the work is significantly impeded because of such conduct.

Such conduct of the employer is considered to be non-fulfilment or irregular fulfilment of his obligations, such as the elimination of deficiencies in the technical documentation on the basis of which the work performs, the advance payment and the payment of a temporary situation.

In such cases the contractor may only suspend works when the reasonable period of time allowed by the contracting authority has expired.

The contractor may also suspend work due to default of the employer only after an appropriate time has elapsed for the employer to fulfil its obligations.

Additionally, the contractor may suspend works in case of *force majeure* or in case of suspension or lifting of the building permit.

3.10 Are there any grounds which automatically or usually entitle a party to terminate the contract? Are there any legal requirements as to how the terminating party's grounds for termination must be set out (e.g. in a termination notice)?

Yes, there are some legal grounds on which a party may automatically or usually terminate the contract. According to the Slovenian OZ, these legal grounds are:

- (a) **Withdrawal from contract because of deviation from agreed conditions**
If, during the execution of the work, it is shown that the contractor is not keeping to the contractual conditions and is not in general working as the contractor should, and that the work executed will have defects, the employer may warn the contractor of this and stipulate a deadline by which the work should be adapted to the obligations. If the contractor fails to fulfil the employer's requirements by this deadline, the employer may withdraw from the contract and demand the reimbursement of damage.
- (b) **Withdrawal from contract prior to deadline**
If the deadline is an essential component of the contract and the contractor is so delayed in starting or finishing the transaction that it is clear that it will not be completed on time, the employer may withdraw from the contract and demand the reimbursement of damage.

The employer shall also have this right when the deadline is not an essential component of the contract if, for reason of the delay, the employer no longer has an interest in the contract being performed.

(c) **Special case of withdrawal from contract**

If the performed transaction has such a defect that the work is useless or if it was performed in breach of express contractual conditions, the employer may withdraw from the contract and demand the reimbursement of damage without previously demanding the rectification of the defect.

If the executed transaction has such a defect that the work would not be useless or if the transaction was not executed in breach of express contractual conditions, the ordering party shall be obliged to allow the contractor to rectify the defect. If the contractor fails to rectify the defect by the stipulated deadline, the ordering party may also choose to withdraw from the contract.

(d) **Termination of contract by employer's wish**

Until the ordered transaction is completed, the employer may withdraw from the contract whenever they wish; however, in this event the employer must pay the agreed payment to the contractor, minus the costs not incurred by the contractor that would have been incurred if the contract had not been rescinded, and also that which was earned elsewhere and that which the contractor had no intention of earning.

(e) **Withdrawal from contract because of higher fee**

If the agreed fee rises significantly, the employer may also withdraw from the contract. In this event, the employer must pay the contractor an appropriate part of the agreed fee for the work performed to date, and a fair reimbursement for necessary costs.

(f) **In general, either party may terminate the contract due to break of contract by the other party**

According to the PGU, all notices (termination notice or warning notice) must be in writing.

3.11 Do construction contracts in your jurisdiction commonly provide that the employer can terminate at any time and for any reason? If so, would an employer exercising that right need to pay the contractor's profit on the part of the works that remains unperformed as at termination?

As mentioned above in question 3.10, the employer can terminate the contract at any time and for any reason; in other words, whenever he wishes. In such case the employer must pay the agreed payment to the contractor, minus the costs not incurred by the contractor that would have been incurred if the contract had not been rescinded, and also that which was earned elsewhere and that which the contractor had no intention of earning.

3.12 Is the concept of *force majeure* or frustration known in your jurisdiction? What remedy does this give the affected party? Is it usual/possible to argue successfully that a contract which has become uneconomic is grounds for a claim for *force majeure*?

In the Slovenian jurisdiction, the concept of *force majeure* is known.

If the performance of obligations becomes impossible for one party to a bilateral contract because of a development for which neither party was responsible, the obligation of the other party shall also expire; if the latter has already performed part of their

obligations, the latter may demand return according to the rules on the return of that which was acquired unjustly.

If the partial impossibility of performance is the consequence of a development for which neither party was responsible, the other party may withdraw from the contract if the partial performance does not satisfy such party's needs; otherwise, the contract shall remain in force and the other party shall have the right to demand the proportionate reduction of such party's obligations.

An uneconomic contract cannot be an event of *force majeure*.

3.13 Are parties, who are not parties to the contract, entitled to claim the benefit of any contractual right which is made for their benefit? E.g. is the second or subsequent owner of a building able to claim against the contractor pursuant to the original construction contracts in relation to defects in the building?

As mentioned above in question 3.5, the contractor shall be liable for any defects in the execution of the structure concerning its solidity or for any deficiencies in the land on which the structure is built if such defects/deficiencies show within 10 years of the delivery and takeover of works, not only to the employer party of the contract, but also to any other acquirer of the structure.

This liability shall also apply to the designer, if the defect in the structure originates from any defect in the plan.

3.14 On construction and engineering projects in your jurisdiction, how common is the use of direct agreements or collateral warranties (i.e. agreements between the contractor and parties other than the employer with an interest in the project, e.g. funders, other stakeholders, and forward purchasers)?

Usually, the contractor provides insurance or collateral warranties to the employer; for example, bank guarantees. Other direct agreements or collateral warranties are not very common in the Slovenian jurisdiction.

3.15 Can one party (P1) to a construction contract, who owes money to the other (P2), set off against the sums due to P2 the sums P2 owes to P1? Are there any limits on the rights of set-off?

Slovenian law allows and permits set-off of monetary claims. One party may offset claims against the other party if those two claims are declared in cash or in other replaceable things of the same type and the same quality, and if both have fallen due.

There are: claims where offset is excluded, especially claims that cannot be attached; claims for things or the value of things that were placed in safekeeping or made available for loan for the debtor, or that the debtor unduly took or retained; claims arising through the intentional infliction of damage; compensation claims for damage done, in relation to damage to health or cause of death; and claims deriving from a lawful obligation to maintenance.

3.16 Do parties to construction contracts owe a duty of care to each other either in contract or under any other legal doctrine? If the duty of care is extra-contractual, can such duty exist concurrently with any contractual obligations and liabilities?

The rights derived from obligational relationships shall be limited by the equal rights of others. It shall be necessary to exercise them in accordance with the basic principles of the Slovenian

OZ and their purpose. When exercising their rights, participants in an obligational relationship must refrain from actions which would render the performance of the obligations of other participants more difficult. When concluding obligational relationships and when exercising the rights and performing the obligations derived from such relationships, the parties must also observe the principle of conscientiousness and fairness. These basic principles can generally be described as the precepts of honesty, respect for the other party's interests and cooperation with the other party.

These principles are a legal framework for parties to an obligation relationship and must be respected at all stages of the obligational relationship, during the performance of the contract as well as during the contract negotiation.

These basic principles exist concurrently with any contractual obligations and liabilities.

3.17 Where the terms of a construction contract are ambiguous, are there rules which will settle how that ambiguity is interpreted?

In the interpretation of ambiguous provisions in the contract, it shall not be necessary to adhere to the literal meaning of the expressions used, but shall be necessary to identify the contracting parties' common intentions and interpret the provision so as to comply with the principles of obligational law set out in the Slovenian OZ.

3.18 Are there any terms which, if included in a construction contract, would be unenforceable?

Yes, according to Slovenian law, construction contracts' terms that contravene the mandatory provisions of law would be unenforceable.

3.19 Where the construction contract involves an element of design and/or the contract is one for design only, are the designer's obligations absolute or are there limits on the extent of his liability? In particular, does the designer have to give an absolute guarantee in respect of his work?

As mentioned above in question 3.5, liabilities for solidity of structure of the building also apply to the designer, if the defect in the structure originates from any defect in the plan. The designer shall be liable within 10 years of the delivery and take-over of the works. The designer shall be liable to the employer and also to any other acquirer of the structure. It is not possible to exclude or limit this designer's liability by contract.

3.20 Does the concept of decennial liability apply in your jurisdiction? If so, what is the nature of such liability and what is the scope of its application?

Yes, in the Slovenian jurisdiction decennial liability is applied. As listed above in question 3.5, the decennial liability period is a warranty period for 10 years from the date of delivery. As a mandatory rule, parties may not agree on a shorter period. This liability refers to the contractor and to the designer. Both shall be liable not only to the ordering party, but also to any other acquirer of the structure.

In the case of decennial liability, any limitation or exclusion of a liability clause will be held as invalid. The contractor's or designer's liability for major defects cannot be limited or excluded.

The decennial liability period is different from the limitation period within which the claim must be filed. The right of the employer or other acquirer against the contractor or designer deriving from their liability for defects shall expire one year after the day the contractor or designer was notified regarding the defect.

4 Dispute Resolution

4.1 How are construction disputes generally resolved?

In general, construction disputes will proceed very quickly, in order to maintain the construction project at a normal pace. Thus, it is crucial that the procedure for resolving construction disputes is as flexible and efficient as possible. Therefore, our courts offer the possibility to solve disputes amicably with mediation in front of the court. In rare cases, when the parties do not resolve the dispute in such a way and conclude a court settlement (or out-of-court settlement, for that matter), parties shall proceed with the litigation.

However, there has been an increased number of disputes that have been settled before arbitration. Therefore, day by day we see an increasing number of arbitration clauses in construction contracts.

4.2 Do you have adjudication processes in your jurisdiction (whether statutory or otherwise) or any other forms of interim dispute resolution (e.g. a dispute review board)? If so, please describe the general procedures.

In the Slovenian jurisdiction, there is no possibility for an adjudication process. However, in accordance with the Contentious Civil Procedure Act, there are some options to accelerate the resolution of disputes, such as preparatory hearings. At the latter, judges can openly discuss with parties the legal and factual aspects of the dispute, where they strive to conclude court settlements. In cases where parties to the dispute, at the end of the preparatory hearing, do not reach an agreement, the judge can start its first official hearing.

As already mentioned in question 4.1, the courts in Slovenia prefer mediation as a way of resolving disputes. The parties can also agree on arbitration before the Chamber of Commerce and Industry of Slovenia or any other arbitration tribunal.

4.3 Do the construction contracts in your jurisdiction commonly have arbitration clauses? If so, please explain how, in general terms, arbitration works in your jurisdiction.

As mentioned above in question 4.1, we see an increasing number of arbitration clauses in construction contracts.

In Slovenian law, the arbitration procedure is governed by the Arbitration Act.

In Ljubljana the Ljubljana Arbitration Centre (LAC) operates, which is an autonomous arbitration institution at the Chamber of Commerce and Industry of Slovenia and which is independent from it. The LAC has been settling disputes since the establishment of the Tribunal of the Ljubljana Chamber of Trade, Craft and Industry in 1928. The LAC is composed of the Board and the Secretariat. The LAC administers the resolution of domestic and international disputes by arbitration in accordance with the Ljubljana Arbitration Rules of the Ljubljana Arbitration Centre at the Chamber of Commerce and Industry of Slovenia (the Ljubljana Arbitration Rules) and other rules

and procedures agreed by the parties, and provides information concerning arbitration, mediation, conciliation and other forms of alternative dispute resolution.

The Ljubljana Arbitration Rules entered into force on 1 January 2014.

Arbitration is a procedure for resolving disputes before the Arbitral Tribunal, which can be composed of one or more arbitrators. The parties may appoint the Arbitral Tribunal themselves and authorise it to reach a final decision on the dispute by making an arbitral award. An award is final and binding on the parties. As regards the parties, an award has the effect of a final and binding court judgment.

Arbitration enables the parties to agree on all relevant aspects of the proceedings (the number of arbitrators, procedural rules, the seat of the arbitration, the language of the proceedings, etc.).

The Ljubljana Arbitration Rules follow the modern international trends in institutional arbitration and ensure the parties a speedy and efficient arbitration together with high-quality services.

4.4 Where the contract provides for international arbitration, do your jurisdiction's courts recognise and enforce international arbitration awards? Please advise of any obstacles (legal or practical) to enforcement.

International arbitral awards are binding and shall be enforced by Slovenian courts.

Slovenia is a member of all major multilateral conventions in the field of international commercial arbitration. Pursuant to Article 8 of the Constitution of the Republic of Slovenia, the ratified and published international treaties are applied directly.

On the basis of reciprocity, the Republic of Slovenia applies the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958 for the recognition and enforcement of arbitral awards issued on the territory of another Convention country.

Domestic judges decline to recognise and enforce international arbitration awards under Article V(2)(b) of the 1958 New York Convention due to violations of procedural law or in cases of "public policy exception".

4.5 Where a contract provides for court proceedings in your jurisdiction, please outline the process adopted, any rights of appeal and a general assessment of how long proceedings are likely to take to reduce: (a) a decision by the court of first jurisdiction; and (b) a decision by the final court of appeal.

The Contentious Civil Procedure Act contains key provisions regarding court proceedings in the Republic of Slovenia. The structure of the Slovenian civil court system comprises first-instance courts, higher courts and the Supreme Court.

At first instance, jurisdiction is divided between local courts and district courts. The jurisdiction of the court of first instance depends on the amount of the dispute: if the dispute's claim is EUR 20,000.00 or less, the lawsuit has to be filed before a local court. When the disputed claim exceeds EUR 20,000.00, the claim has to be filed before the district court. When the disputed claim in commercial cases is lower than EUR 4,000.00, such claim is subject to simplified procedural rules. However, the latter also applies in other civil cases when the amount of the disputed claim is lower than EUR 2,000.00. Cases in civil proceedings before the local and district courts are generally decided by a single judge.

Starting civil proceedings requires the claimant to file an action, which is subsequently served to the defendant. Invitation to mediation is also a part of this step in the proceedings. The defendant has the right to file a statement of defence within 30 days after receiving the action of the claimant.

Each party may file two written submissions during preparations for the main hearing.

After the court receives a statement of defence, a preliminary hearing is scheduled. A preliminary hearing encompasses discussion with the parties regarding factual and legal questions of the dispute; a timetable for the proceedings is also set out.

The first hearing which follows precludes the parties from making new statements on facts and submitting evidence in the following hearings. At the subsequent hearings the evidence is considered by the court. After the final hearing has been held, the court prepares a written judgment within 30 days.

The parties are obliged to state all facts on the grounds of which their claims are based, and to propose evidence confirming such facts. The judgment is issued based on the facts and evidence presented to the court.

A decision of the court must be within the frame of the claims being filed in the procedure. The parties can waive their claim, recognise the claim of the opponent and settle. In general, the court decides on the petition on the basis of an oral, direct and public negotiation.

In the Republic of Slovenia, approximately one-third of cases are resolved in absence of a hearing.

In general, the average proceeding at first instance takes about 12 months. The duration of proceedings depends mainly on the nature and complexity of the case and the conduct of the parties to the proceedings.

An appeal against the judgment of a first-instance court is decided by the higher courts. In certain cases, the parties may also file an extraordinary remedy to the Supreme Court. The average proceeding at higher courts takes about six months.

4.6 Where the contract provides for court proceedings in a foreign country, will the judgment of that foreign court be upheld and enforced in your jurisdiction? If the answer depends on the foreign country in question, are there any foreign countries in respect of which enforcement is more straightforward (whether as a result of international treaties or otherwise)?

It highly depends on which court issues a judgment. If the judgment is issued by the court of a country that is a Member State of the European Union, such judgment (based on Regulation (EU) No 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters) shall be recognised in Slovenia without any special procedure being required. Regarding the enforcement, such judgment shall be enforceable in Slovenia without any declaration of enforceability being required.

In order to do this, the applicant shall provide a copy of the judgment which satisfies the conditions necessary to establish its authenticity, and a certificate concerning a judgment in civil and commercial matters issued by the court of origin, certifying that the judgment is enforceable and containing an extract of the judgment as well as, where appropriate, relevant information on the recoverable costs of the proceedings and the calculation of interest.

When the court of origin is outside of the EU, the Private International Law and Procedure Act is applicable. A foreign judgment has the same status as a judgment issued by the court of the Republic of Slovenia and has the same legal effect in the Republic of Slovenia as a domestic judgment, only if it is recognised by a court of the Republic of Slovenia. Such rule is also applicable in cases of court settlements. A petitioner for recognition of a foreign judgment shall attach to his petition the foreign judgment in question or its authenticated copy, and submit an attestation of a competent foreign court or another body, proving his decision to be final under the laws of the State in which it was issued. However, the Act is not used for relations which are regulated by another act or an international treaty.



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Ms. Prelog Neffat is always up to date with decisions of the Court of Justices of the European Union, the Slovenian Information Commissioner, the Court of Appeal and the Supreme Court of the Republic of Slovenia, the National Review Commission and the Court of Audit, since she is the founder and CEO of the company jnp.si which analyses and publishes all the decisions weekly. Therefore, she can always give advice that is up to date in accordance with current practice.

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Law Firm Neffat has a long tradition that is rapidly developing in the Republic of Slovenia. The Firm actively works in the fields of Corporate Law, M&A, Public Procurement, Waste Management and Environmental Law, Construction and Engineering law, Real Estate, Litigation, Commercial Law, GDPR, White-Collar Crime, Copyright Law and many others.

In an increasingly complex economic world, we believe that our role is to assist our clients: working out the best possible course of action resulting from various situations; obtaining efficient, comprehensive and tailored legal advice in various complex situations; and optimising decision-making in every manner possible. In order to achieve this, our team believes that the quality of the relationship that we have with our clients is one of the

key factors to the success of the legal work entrusted to us and we must understand the economic, sector-based, financial and managerial culture of our clients.

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Philippe Prost



Jacques Johner

1 Making Construction Projects

1.1 What are the standard types of construction contract in your jurisdiction? Do you have: (i) any contracts which place both design and construction obligations upon contractors; (ii) any forms of design-only contract; and/or (iii) any arrangement known as management contracting, with one main managing contractor and with the construction work done by a series of package contractors? (NB For ease of reference throughout the chapter, we refer to “construction contracts” as an abbreviation for construction and engineering contracts.)

In Swiss contract law, pursuant to the Swiss Code of Obligations (CO), freedom of contracts and priority to the parties’ intentions are the main principles that apply. Swiss statutory law contains many general and specific contractual rules regulating certain types of contract, such as those relating to construction. However, subject to mandatory legal provisions, parties are generally free to deviate from statutory law by altering provisions or adding new ones.

Parties can therefore enter into all types of contracts and define their content. As a consequence, in practice, there are various types and configurations of contractual arrangements that may be concluded in the context of a construction project, depending on its complexity, regardless of whether the main parties are local or international: (i) in terms of design and construction obligations of the contractor, the total contractor’s model is very common in practice, in particular for complex projects. In such configuration, the total contractor both designs the project in coordination with architects and other planners and executes it as a general contractor does; (ii) one can also freely decide to separately mandate an architect only for the design and to entrust a general contractor or various specialised contractors for the performance of the work; and (iii) management contracting is also an option, as it is a declination of the total/general contractor’s model. In this case, the management contractor manages the different contractors at the same worksite.

1.2 How prevalent is collaborative contracting (e.g. alliance contracting and partnering) in your jurisdiction? To the extent applicable, what forms of collaborative contracts are commonly used?

Collaborative contracting is a concept that is not yet commonly used in Switzerland, at least not under this term.

1.3 What industry standard forms of construction contract are most commonly used in your jurisdiction?

In Swiss construction and design contracts, the standard terms issued by the Swiss Society of Engineers and Architects (SIA) are widely used. There are different rules for different types of work. For instance, SIA rule 118 is relevant to construction contracts, whereas SIA regulations 102 and 103 are used for contracts with architects and construction engineers, respectively. Often, because the parties have to expressly include those regulations in their contract if they want them to apply, they do so and modify them where needed. In the context of public procurement, the KBOB (the Co-ordination Conference of the responsible federal and cantonal clients and owners) issued a standard form for general and total contractor agreements. However, it is more and more common for KBOB contracts to be concluded in relation to private projects. In the international context, the various sets of conditions issued by FIDIC (International Federation of Consulting Engineers) are the most common standard forms.

1.4 What (if any) legal requirements are there to create a legally binding contract (e.g. in common law jurisdictions, offer, acceptance, consideration and intention to create legal relations are usually required)? Are there any mandatory law requirements which need to be reflected in a construction contract (e.g. provision for adjudication or any need for the contract to be evidenced in writing)?

Similarly to any other contract under Swiss law, the creation of a construction contract involves the exchange of an offer and the resultant acceptance of the two contracting parties. Both expressions of will must encompass the *essentialia negotii* of the construction contract, which is the work to be carried out and its price (article 363 CO). However, it is not necessary for parties to agree on a fixed price or the manner of calculating it, as article 374 CO contains a general rule in this regard. As to the form of the contract, there are no special conditions, although most construction contracts are made in writing for clarity and evidentiary purposes.

1.5 In your jurisdiction please identify whether there is a concept of what is known as a “letter of intent”, in which an employer can give either a legally binding or non-legally binding indication of willingness either to enter into a contract later or to commit itself to meet certain costs to be incurred by the contractor whether or not a full contract is ever concluded.

Under Swiss law, a “letter of intent” usually has no binding effect,

unless unequivocally specified by the parties and provided that it does not contain all the *essentialia negotii*.

However, the letter of intent obliges each party to negotiate in good faith. In some circumstances, a breach of such a pre-contractual obligation may involve liability for damages even if the main contract has not been concluded (*culpa in contrahendo*).

1.6 Are there any statutory or standard types of insurance which it would be commonplace or compulsory to have in place when carrying out construction work? For example, is there employer's liability insurance for contractors in respect of death and personal injury, or is there a requirement for the contractor to have contractors' all-risk insurance?

Construction work requires many insurances. In most cantons, it is compulsory to take out an insurance covering fire and elementary damages during the works.

The building owner often takes out a civil liability insurance covering damages caused to third parties in relation to his specific project. In addition, it is common for the owner, contractor and other parties involved to take out an insurance covering damages to the building during the process.

Material and tools on the worksite are usually also insured by their respective owner.

Contractors often take out – and the employer will often request – insurance covering claims of the employer for defects that appear during the warranty period.

1.7 Are there any statutory requirements in relation to construction contracts in terms of: (a) labour (i.e. the legal status of those working on site as employees or as self-employed sub-contractors); (b) tax (payment of income tax of employees); and/or (c) health and safety?

Swiss law contains norms of labour and public law whose objective is the protection of workers, the payment of income tax and the preservation of the employees' health and safety.

Construction sites are regularly inspected by authorities, in particular to prevent undeclared work. In the event of breaches of the regulations, the authority can stop the construction work and impose administrative fines. Constructors must be aware that they may also be held liable for violation by their sub-contractors.

Concerning labour law, the employer has to comply with general principles such as the non-discrimination and equal treatment principles. It is common in practice that collective labour schemes set minimum standards for workers that have to be followed by the employer. There are also mandatory declarations that have to be made in the context of public procurements. In case of non-compliance, the contractor might be blacklisted.

There are also specific regulations that apply to certain foreign workers in Switzerland both in terms of labour and taxes, for example requiring the employer to pay the tax of employees (withdrawal tax).

In terms of health and safety, Swiss labour law as well as Swiss administrative and environmental law set numerous regulations regarding the protections of the workers (equipment, hours of work, etc.) and the use and storage on the worksite of toxic materials, asbestos, PCB, leaded paint, chemicals, etc.

1.8 Is the employer legally permitted to retain part of the purchase price for the works as a retention to be released either in whole or in part when: (a) the works are substantially complete; and/or (b) any agreed defects liability period is complete?

Yes. Even though this is not mentioned in the law, retention of part of the purchase price (usually 5–10%) is common in construction projects, whether part of the contract or other applicable standards. It either comes in addition or instead of a performance bond (see question 1.9). Parties are free to decide whether the retention is released upon the acceptance of the works or after the defects liability period is complete, even though 100% of the price is usually paid when the works are substantially completed. Pursuant to SIA rules, it is the latter option that prevails.

1.9 Is it permissible/common for there to be performance bonds (provided by banks and others) to guarantee the contractor's performance? Are there any restrictions on the nature of such bonds? Are there any grounds on which a call on such bonds may be restrained (e.g. by interim injunction); and, if so, how often is such relief generally granted in your jurisdiction? Would such bonds typically provide for payment on demand (without pre-condition) or only upon default of the contractor?

It is not uncommon for the contractor to be required to provide a performance bond, which subordinates the achievement of the works, predominantly for important construction works. It is, however, much rarer in smaller projects. Upon achievement, a guarantee concerning the defects of the construction must then be provided.

Both the performance guarantee and the defects warranty are generally secured by a bank guarantee or a security bond. In such a case, the guarantor's bank undertakes to pay to the party benefiting from the guarantee, upon its first demand, any amount up to a defined maximum. Such guarantee is irrevocable, unconditional and may be exercised if certain obligations are not properly fulfilled.

A guarantor can seek interim measures (relief) against a guarantee's calling. However, in an interim measure litigation, the guarantor must demonstrate (with readily available evidence) that the calling of the guarantee constitutes a manifest abuse of rights by the creditor. The courts tend to take a very restrictive approach on this issue as a bond/guarantee is of an abstract nature. The principle usually applied by courts (and banks) is "pay first, litigate after".

1.10 Is it permissible/common for there to be company guarantees provided to guarantee the performance of subsidiary companies? Are there any restrictions on the nature of such guarantees?

Yes, generally speaking, it is permissible to have downstream guarantees (as an obligation of the subsidiaries of the guarantor), although this is not very common in construction projects. In this context, the Swiss CO foresees a number of forms of guarantees that are admissible.

1.11 Is it possible and/or usual for contractors to have retention of title rights in relation to goods and supplies used in the works? Is it permissible for contractors to claim that, until they have been paid, they retain title and the right to remove goods and materials supplied from the site?

A right as described in the question does not exist in Switzerland. It would be deemed a strong violation of property rights in Swiss law. Nevertheless, any contractors that have supplied labour and materials, or labour alone, for construction work, demolition work or other similar works may register a legal mortgage on the property. This right is granted to all contractors, even if they are not in a direct contractual relationship with the employer or property owner.

Legal mortgages are one of the most efficient methods for contractors to secure payment claims. These are broadly used in practice, given that their provisional registration can be obtained easily, quickly and at a low cost through a summary judicial procedure.

2 Supervising Construction Contracts

2.1 Is it common for construction contracts to be supervised on behalf of the employer by a third party (e.g. an engineer)? Does any such third party have a duty to act impartially between the contractor and the employer? If so, what is the nature of such duty (e.g. is it absolute or qualified)? What (if any) recourse does a party to a construction contract have in the event that the third party breaches such duty?

When he deems it appropriate, the employer will usually appoint an architect to supervise the contractor or the general contractor, checking the works and invoices on his behalf. The architect has a duty of loyalty to the employer and a duty of care *vis-à-vis* him only.

2.2 Are employers free to provide in the contract that they will pay the contractor when they, the employer, have themselves been paid; i.e. can the employer include in the contract what is known as a “pay when paid” clause?

Even though such a clause is not frequently used in Swiss construction contracts, parties are free to agree on “paid if paid” or “paid when paid” provisions. However, according to Swiss statutory law, unless otherwise agreed between parties, payment for construction work is due upon completion or delivery. If parties agreed on a delivery in parts and a payment by instalments, the amount due for each phase is payable upon delivery of the partial work agreed.

In addition, the right of subcontractors to register a legal mortgage is mandatory and may not be validly waived with subcontractor agreements.

2.3 Are the parties free to agree in advance a fixed sum (known as liquidated damages) which will be paid by the contractor to the employer in the event of particular breaches, e.g. liquidated damages for late completion? If such arrangements are permitted, are there any restrictions on what can be agreed? E.g. does the sum to be paid have to be a genuine pre-estimate of loss, or can the contractor be bound to pay a sum which is wholly unrelated to the amount of financial loss likely to be suffered by the employer? Will the courts in your jurisdiction ever look to revise an agreed rate of liquidated damages; and, if so, in what circumstances?

Liquidated damages are not explicitly regulated by statutory Swiss law but are nevertheless admissible. These are treated in the same way as contractual penalties, despite their purpose not being to penalise – in opposition to contractual penalties – but rather to compensate an anticipated damage. To assess whether parties agreed upon liquidated damages or a contractual penalty, their true intention is relevant rather than the potentially incorrect designation used in the agreement.

If liquidated damages exceed the actual damage incurred, they are subject to the same judicial review and possible reduction that applies to the contractual penalty (article 163 para. 3 CO).

3 Common Issues on Construction Contracts

3.1 Is the employer entitled to vary the works to be performed under the contract? Is there any limit on that right?

As a general principle, parties to a construction agreement are always free to modify its contractual terms, including the works, as long as they agree on the modification and respect the mandatory nature/scope of the contract. With regard to the works description, construction contracts usually contain a “change order” clause that entitles the employer to seek variations to the works during the execution of the contract. However, in such event, the parties have to agree (generally in writing) on the scope of the change and its consequences on the price and delivery date.

3.2 Can work be omitted from the contract? If it is omitted, can the employer carry out the omitted work himself or procure a third party to perform it?

If the contractor has omitted the work due to lack of diligence, the employer will first have to warn the contractor and seek for remediation at the delivery of the works. If the contractor does not remedy the works within an agreed and reasonable timeframe, the employer is allowed to ask a third party to perform it *in lieu* of the contractor at the latter’s risks and costs.

However, once the delivery has taken place, the employer can only ask the contractor for a reduction of the price (article 368 CO).

3.3 Are there terms which will/can be implied into a construction contract (e.g. a fitness for purpose obligation, or duty to act in good faith)?

Switzerland is a civil law country. The common law concept of “implied terms” does not exist under Swiss law, which contains mandatory and non-mandatory statutory provisions that would apply if the parties have not regulated certain issues in their contract. For construction contracts, the statutory provisions are contained in article 363 CO, while for engineering contracts, the relevant provisions can either be article 363 CO or article 394 CO depending on how the contract is qualified. In addition, the parties will frequently refer to the corresponding SIA regulations which set the industry standard and state of the art.

3.4 If the contractor is delayed by two concurrent events, one the fault of the contractor and one the fault or risk of his employer, is the contractor entitled to: (a) an extension of time; and/or (b) the costs arising from that concurrent delay?

Swiss law has not yet provided a clear answer to this question.

The response depends on the importance of the two events and their factual circumstances.

However, the current trend is that in such event, the contractor would be entitled to an extension of time, even if he is partly at fault for the delay, and would not be entitled to claim for costs resulting from his own delay.

3.5 Is there a time limit beyond which the parties to a construction contract may no longer bring claims against each other? How long is that period and when does time start to run?

Yes. On the one hand, the CO provides limitation periods depending on the type of claim (of five and 10 years, respectively; see article 127 *et seq.* and article 371 CO). On the other hand, contractual or statutory notice requirements may impose a much shorter time limit on a party that wishes to assert that a claim must be observed. In particular, according to article 370 CO, the employer has to notify hidden defects immediately upon their discovery. The parties may, however, agree on diverging notice requirements or warranty periods in their contracts.

3.6 Which party usually bears the risk of unforeseen ground conditions under construction contracts in your jurisdiction?

The employer usually bears this risk because the contractor does not often agree on bearing it, as it may have a significant impact on deadlines, the price and the quality of the works.

3.7 Which party usually bears the risk of a change in law affecting the completion of the works under construction contracts in your jurisdiction?

Swiss statutory law does not cover this issue. In practice, the construction agreement provides that the contractor will perform the works based on the current legal provisions at the time of its conclusion. Therefore, any change of law that might impact important aspects of the agreement, such as the price, deadlines and quality of the works, would trigger a mutual modification of the contract and the employer will usually bear the associated risks and costs.

Given the freedom of contract principle, it is, however, admissible for parties to agree to have either this charge borne by the employer or the contractor, or to have it shared between them.

3.8 Which party usually owns the intellectual property in relation to the design and operation of the property?

The architect primarily owns the full intellectual property rights in relation to the design he drew and can assign them to the contractor or the property owner. However, only patrimonial intellectual property rights are transmissible (and not moral rights such as the copyright on the works).

3.9 Is the contractor ever entitled to suspend works?

The parties are always free to negotiate the suspension of the work if this is required by external circumstances. Moreover, pursuant to article 82 CO, each party may suspend the performance of its own obligation, including payment or works, if the other party has failed to timely perform its corresponding obligation (*exceptio non adimpleti contractus*).

In specific cases, the contractor is allowed to suspend the work unilaterally if the continuation of the work could result in strong and otherwise inevitable damages for the employer or if any decision from a public authority obliges him to do so.

3.10 Are there any grounds which automatically or usually entitle a party to terminate the contract? Are there any legal requirements as to how the terminating party's grounds for termination must be set out (e.g. in a termination notice)?

Each party is allowed to terminate the contract if the other party does not respect its obligation, i.e. if the contractor fails to start the work on time or performs it in a defective manner, respectively if the employer fails to pay the contractor for the work done.

On his side, the employer may unilaterally withdraw from the contract at any time before the work is completed, provided he pays for the work already done and compensates the contractor in full. In addition, where an estimate agreed with the contractor is exceeded by a disproportionate amount through no fault of the employer, the latter has the right to withdraw from the contract before or after completion.

Extraordinary circumstances (e.g., *force majeure*) may lead to the contract's termination, only after a court finds that even with a price adaptation, the execution of the contract cannot be reasonably required and rules so.

In practice, parties to a construction contract frequently include in their agreement a list of events qualifying as acceptable grounds, such as insolvency or bankruptcy of a party, repeated and serious breach of the contract or major delay in the start or delivery of the work, which entitle each party to terminate the contract early.

The termination notice is usually served in the same form as the contract and the specific communication rules provided for in the contract, if any, have to be followed.

3.11 Do construction contracts in your jurisdiction commonly provide that the employer can terminate at any time and for any reason? If so, would an employer exercising that right need to pay the contractor's profit on the part of the works that remains unperformed as at termination?

Yes, as mentioned under question 3.10, pursuant to article 377 CO, the employer can withdraw from the contract at any time, provided that it pays for work already done and compensates the contractor in full.

3.12 Is the concept of *force majeure* or frustration known in your jurisdiction? What remedy does this give the affected party? Is it usual/possible to argue successfully that a contract which has become uneconomic is grounds for a claim for *force majeure*?

Swiss law recognises the concept of *force majeure*, even though it is not described as such in statutory law. In accordance with article 119, para. 1 CO, an obligation is deemed extinguished when its performance is made impossible by circumstances that are entirely beyond the control of the concerned party and the performance has therefore become strictly impossible (either temporarily or permanently). In such an event, the contractor does not breach the obligations that are impacted as long as the impossibility persists.

With respect to *force majeure* events, the parties can allocate the related risks in the contract. If they do not regulate this topic in

the contract, some legal, non-mandatory, statutory provisions of the CO can apply. For example, article 376 CO states that if the work is destroyed by accident and prior to completion or delivery, the contractor is not entitled to payment for the work done or of the expenses incurred, unless the employer is in default on acceptance of the work. Similarly, article 378 CO provides that if the completion of the work is rendered impossible by an incidental occurrence affecting the employer, the contractor is entitled to payment for the work already done and the expenses incurred that were not included in the price. The contractor may further claim for compensation if such impossibility is due to the employer's fault.

In case of lump sum contracts, *force majeure* events may lead to a price increase or to the termination of the contract (article 373, para. 2 CO).

Concerning hardship or economic impossibility, the affected party may ask to amend the terms of the contract or request its termination if the subsequent circumstances have changed in such way that the performance of the contractual obligation would become excessively burdensome (*clausula rebus sic stantibus*).

3.13 Are parties, who are not parties to the contract, entitled to claim the benefit of any contractual right which is made for their benefit? E.g. is the second or subsequent owner of a building able to claim against the contractor pursuant to the original construction contracts in relation to defects in the building?

Swiss law strictly applies the principle of privity of contracts, the result being that third parties do not have any right deriving from the contract, unless specific rights have been duly assigned to them. This may, for example, be the case if the subsequent owner of the building was entitled to a claim against the contractor if the deed of sale of the building includes an assignment of the seller's rights under the original construction contract in his favour.

However, not all rights can be transferred to a third party. Usually, such agreements take the form of a tripartite agreement with proxy.

3.14 On construction and engineering projects in your jurisdiction, how common is the use of direct agreements or collateral warranties (i.e. agreements between the contractor and parties other than the employer with an interest in the project, e.g. funders, other stakeholders, and forward purchasers)?

In Switzerland, it is not very common to see such agreements in the context of construction projects.

3.15 Can one party (P1) to a construction contract, who owes money to the other (P2), set off against the sums due to P2 the sums P2 owes to P1? Are there any limits on the rights of set-off?

Pursuant to article 120 CO, where two persons owe each other sums of money or performance of identical obligations, and provided that both claims are due, each party may unilaterally decide to set off his debt against his claim. There is no limitation to the use of this right, but the party who does so must expressly declare that it is doing so.

3.16 Do parties to construction contracts owe a duty of care to each other either in contract or under any other legal doctrine? If the duty of care is extra-contractual, can such duty exist concurrently with any contractual obligations and liabilities?

According to article 2 of the Swiss Civil Code, parties to any contract owe each other a duty to act in good faith. Parties have to cooperate in order to help each other perform their respective obligations, namely by providing relevant information to each other in due course. For example, the contractor has an obligation to inform the employer of any defect in the design (article 364 CO).

3.17 Where the terms of a construction contract are ambiguous, are there rules which will settle how that ambiguity is interpreted?

Under Swiss law, when the terms of a construction contract are ambiguous, the judge will first try to establish the true and common intention of the parties, using an empirical approach, despite any inaccurate expressions or designations used either in error or by way of disguising the true nature of their agreement. If the true intention cannot be identified at this first stage, the judge will then, by applying the *principle of trust*, seek to determine what meaning the parties could and should have given to their mutual expressions of will pursuant to the rules of good faith, taking into account all of the circumstances.

3.18 Are there any terms which, if included in a construction contract, would be unenforceable?

As Swiss law has a very liberal approach, most of the terms chosen by the parties will be enforceable. Nevertheless, contract clauses that deviate from those prescribed by law are only admissible where the law does not prescribe mandatory wording and provided that they do not contravene public policy, morality or rights of personal privacy (article 19, paragraph 2 CO). Therefore, contractual terms that go against mandatory statutory law are unenforceable.

3.19 Where the construction contract involves an element of design and/or the contract is one for design only, are the designer's obligations absolute or are there limits on the extent of his liability? In particular, does the designer have to give an absolute guarantee in respect of his work?

In terms of extent, the liability of the designer is similar to any other party's liability. Swiss law does not make any distinction regarding a designer's liability with any other contractor. In addition, the liability will be defined based on the qualification of the contract, which depends on the factual circumstances and not on the determination of the contract itself (mainly "mandate" or "contractor's agreement"). Therefore, the obligation of the designer will be to work towards a result, but without guaranteeing it or to obtain it.

3.20 Does the concept of decennial liability apply in your jurisdiction? If so, what is the nature of such liability and what is the scope of its application?

Under Swiss law, liability for defects is governed by article 371 CO (see question 3.5 above).

In practice, parties frequently modify the liability regime by including SIA rule 118 in their agreement. Hence, it is very unusual for them to agree on more than a five-year liability period. Such extensions are typically agreed, in certain sectors, in relation to a specific part of the work (e.g. sealing) and provided that the building owner enters into a maintenance contract with the contractor.

Finally, there is also a 10-year liability period that applies only to defects intentionally hidden by the contractor.

4 Dispute Resolution

4.1 How are construction disputes generally resolved?

The parties can freely define the mechanism for dispute resolution. The most commonly used formal dispute resolution mechanism is State court litigation or, more rarely, domestic arbitration, while international contracts often provide for international institutional (SCAI, ICC) or *ad hoc* arbitration.

4.2 Do you have adjudication processes in your jurisdiction (whether statutory or otherwise) or any other forms of interim dispute resolution (e.g. a dispute review board)? If so, please describe the general procedures.

An adjudication process is not provided by statute under Swiss law. It is rarely used in construction contracts for small and medium-sized construction projects. In contrast, it is more frequently seen in international or large-scale projects.

4.3 Do the construction contracts in your jurisdiction commonly have arbitration clauses? If so, please explain how, in general terms, arbitration works in your jurisdiction.

In Switzerland, arbitration clauses are rare in practice. This type of clause is more common for contracts relating to large or complex projects and/or when at least one of the parties is *a person abroad*.

Arbitration is possible in Switzerland both in domestic and international matters. In the former case, article 353 *et seq.* of the Civil Procedural Code (CPC) will apply (unless the parties decide that article 172 of the Swiss Private International Law Act, PILA, will apply). In the latter case, article 172 PILA will apply. A notable difference between the two is the possibility for the parties to appeal against a domestic arbitral award, whereas no appeal is possible in international arbitration (awards may, however, be challenged on the basis of very limited grounds – public order, improper composition of the Arbitration panel, violation of the right to be heard).

SIA has published a specific arbitration regulation (SIA 150), but it is not often used in contracts.

Parties are free to determine the arbitration procedure and to decide on the procedural steps, subject to the requirements of due process.

4.4 Where the contract provides for international arbitration, do your jurisdiction's courts recognise and enforce international arbitration awards? Please advise of any obstacles (legal or practical) to enforcement.

Switzerland is a party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. Switzerland has made no reservations, withdrawing its declaration of reservation in 1993.

Both domestic and international arbitral awards are easily recognised and enforced. As a matter of fact, the Swiss Supreme Court does not review the merits of an international award unless it manifestly violates public policy.

4.5 Where a contract provides for court proceedings in your jurisdiction, please outline the process adopted, any rights of appeal and a general assessment of how long proceedings are likely to take to reduce: (a) a decision by the court of first jurisdiction; and (b) a decision by the final court of appeal.

As Switzerland is organised as a federal system, all Swiss Cantons have their own judiciary system. Nevertheless, the Swiss CPC obliges each Canton to set up a double judiciary instance system. Therefore, parties have a right to appeal in the Canton. Moreover, under very strict conditions, the Swiss federal Supreme Court, which is the highest court in Switzerland, may review final decisions of the cantonal courts of appeal, but only on matters of law, not facts.

The length of those proceedings can last between two and five years. The first instance proceedings are the longest as they usually include hearings, expert opinions, proof examinations, etc. These could last two years or much more depending on the complexity of the case. Moreover, interim measure such as expert opinions can also take a few months.

Courts of appeal are faster and usually take their decision within a year, while the Swiss federal Supreme Court generally issues its rulings within six to nine months.

4.6 Where the contract provides for court proceedings in a foreign country, will the judgment of that foreign court be upheld and enforced in your jurisdiction? If the answer depends on the foreign country in question, are there any foreign countries in respect of which enforcement is more straightforward (whether as a result of international treaties or otherwise)?

Enforcement depends on the country where the judgment was rendered. EU judgments will typically be easier to enforce in Switzerland (on the basis of the Lugano Convention) than those of other countries with which no international treaty exists.



Philippe Prost gives legal advice to companies and private clients regarding real estate acquisitions or sales, constitution or sale and purchase of rights of acreage (land lease), construction projects, architect and engineer contracts, financing of real estate projects and mortgage negotiations, related tax issues, lease contracts, drafting and reviewing of contracts, including the due diligence process.

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1 Making Construction Projects

1.1 What are the standard types of construction contract in your jurisdiction? Do you have: (i) any contracts which place both design and construction obligations upon contractors; (ii) any forms of design-only contract; and/or (iii) any arrangement known as management contracting, with one main managing contractor and with the construction work done by a series of package contractors? (*NB* For ease of reference throughout the chapter, we refer to “construction contracts” as an abbreviation for construction and engineering contracts.)

Depending on the contractors’ scope of work, the International Federation of Consulting Engineers (“FIDIC”) classifies construction contracts into three types: turnkey/engineering, procurement and construction (“EPC”); design-build; and construction. But in Taiwan, the line between turnkey/EPC and design-build is rather blurred. The Government Procurement Act (“GPA”), the law governing government procurement projects in Taiwan, defines turnkey as a type of construction contract where the contractor is responsible for detailed design and on-site performance. This broad definition covers both turnkey/EPC and design-build.

Procurement and Construction Management (“PCM”) is also widely used in Taiwan, especially in large-scale construction projects. In these projects, construction consulting firms are hired to help employers manage and oversee their contractors’ performance.

1.2 How prevalent is collaborative contracting (e.g. alliance contracting and partnering) in your jurisdiction? To the extent applicable, what forms of collaborative contracts are commonly used?

Collaborative contracting is not adopted in Taiwan. In construction projects, employers would sign contracts with their consultants and contractors individually. If the contractors wish to subcontract their work, they enter into separate contracts with their subcontractors.

1.3 What industry standard forms of construction contract are most commonly used in your jurisdiction?

In Taiwan, construction projects usually come from the government. Where the government is the employer, contract templates created by the Public Construction Commission (“PCC”), the

agency administering government procurement matters in Taiwan, are used. FIDIC contracts, despite their global currency, are seldom used by employers in Taiwan.

1.4 What (if any) legal requirements are there to create a legally binding contract (e.g. in common law jurisdictions, offer, acceptance, consideration and intention to create legal relations are usually required)? Are there any mandatory law requirements which need to be reflected in a construction contract (e.g. provision for adjudication or any need for the contract to be evidenced in writing)?

Under Taiwan’s Civil Code, a contract is formed and binds the parties as long as the parties agree on the major terms of the contract. The agreement does not have to be in writing; oral agreement is also recognised. For construction contracts, the major terms include scope of work and payment. As long as the employer and its contractor agree on the principal terms, orally or in writing, the construction contract will be deemed formed and legally binding.

1.5 In your jurisdiction please identify whether there is a concept of what is known as a “letter of intent”, in which an employer can give either a legally binding or non-legally binding indication of willingness either to enter into a contract later or to commit itself to meet certain costs to be incurred by the contractor whether or not a full contract is ever concluded.

Letters of intent are not common in construction projects. Employers in Taiwan – mostly government agencies – are required to follow the mandatory bidding process, and letters of intent are not required by the process. Once the winning bidder is determined, the employer will sign a formal contract with the bidder directly.

However, in some projects, the contractors will enter into letters of intent with their subcontractors to demonstrate both parties’ willingness to cooperate. These are mostly non-binding.

1.6 Are there any statutory or standard types of insurance which it would be commonplace or compulsory to have in place when carrying out construction work? For example, is there employer’s liability insurance for contractors in respect of death and personal injury, or is there a requirement for the contractor to have contractors’ all-risk insurance?

Labour insurance is required by law, but construction insurance is not. While every contractor is obligated to procure

labour insurance for all its workers, it is free to negotiate with its employer as to the type of construction insurance it will purchase. The most common type of insurance in the construction industry is a commercial general liability policy, and where necessary, the employer can require additional insurance policies from its contractor. Also, most construction contracts prescribe the major terms of the policies, such as the insured, the scope of coverage and the maximum deductible, to ensure that any property loss, or personal injury or damage during construction will be properly covered.

1.7 Are there any statutory requirements in relation to construction contracts in terms of: (a) labour (i.e. the legal status of those working on site as employees or as self-employed sub-contractors); (b) tax (payment of income tax of employees); and/or (c) health and safety?

Under Taiwan law, a contractor has to procure labour and national health insurance for its workers. If the contractor subcontracts its work to a subcontractor, the subcontractor is also subject to the same legal requirement. As the employers, both the contractor and the subcontractor are required to deduct income tax from their workers' paycheques. The law governing occupational health and safety also requires that contractors/subcontractors take necessary precautions to prevent their workers from any on-site dangers. These legal requirements are standard provisions in most construction contracts in Taiwan, and will still bind the contractors/subcontractors even if not prescribed in the contracts.

1.8 Is the employer legally permitted to retain part of the purchase price for the works as a retention to be released either in whole or in part when: (a) the works are substantially complete; and/or (b) any agreed defects liability period is complete?

Yes, the employer is entitled to keep part of the construction payment due to the contractor – usually 5% of every monthly payment – as a retention, as long as the right is explicitly specified in the contract. Usually the retention is released to the contractor when the contractor's work is accepted by the employer.

1.9 Is it permissible/common for there to be performance bonds (provided by banks and others) to guarantee the contractor's performance? Are there any restrictions on the nature of such bonds? Are there any grounds on which a call on such bonds may be restrained (e.g. by interim injunction); and, if so, how often is such relief generally granted in your jurisdiction? Would such bonds typically provide for payment on demand (without pre-condition) or only upon default of the contractor?

Performance bonds are used in almost all construction projects in Taiwan, especially those awarded by the government. Performance bonds typically provide for payment on demand. Although a provisional injunction from the court can undercut an employer's right to call the bond, an application for a provisional injunction is seldom granted.

1.10 Is it permissible/common for there to be company guarantees provided to guarantee the performance of subsidiary companies? Are there any restrictions on the nature of such guarantees?

Corporate guarantees are rarely used in Taiwan. As indicated, most construction projects come from the public sector, where

government agencies are the employers. They prefer bank guarantees over corporate guarantees, even if the guarantees are issued by established companies.

1.11 Is it possible and/or usual for contractors to have retention of title rights in relation to goods and supplies used in the works? Is it permissible for contractors to claim that, until they have been paid, they retain title and the right to remove goods and materials supplied from the site?

Goods and supplies used in the works usually belong to the employer under the contract. The contractor may claim title rights of the goods and supplies if: (1) the contract is silent on the distribution of the title rights; and (2) the goods and supplies have not become an integral part of the works.

2 Supervising Construction Contracts

2.1 Is it common for construction contracts to be supervised on behalf of the employer by a third party (e.g. an engineer)? Does any such third party have a duty to act impartially between the contractor and the employer? If so, what is the nature of such duty (e.g. is it absolute or qualified)? What (if any) recourse does a party to a construction contract have in the event that the third party breaches such duty?

Yes, in a government procurement project the employer would usually hire a third party, most often an engineer or engineering company, to supervise the contractor's performance of the contract. As the third party is hired by the employer, it is not obligated to act impartially between the contractor and the employer; rather, its conduct will be deemed the employer's. If the third party breaches the contract, the contractor can claim any remedy that applies if the employer breaches the contract.

2.2 Are employers free to provide in the contract that they will pay the contractor when they, the employer, have themselves been paid; i.e. can the employer include in the contract what is known as a "pay when paid" clause?

The "pay when paid" clause is not prohibited by the law, but it is not used in contracts between the employers and their contractors because construction payments usually come from the employers. However, many contractors will put the clause into the contracts with their subcontractors to keep their cash flow in check.

2.3 Are the parties free to agree in advance a fixed sum (known as liquidated damages) which will be paid by the contractor to the employer in the event of particular breaches, e.g. liquidated damages for late completion? If such arrangements are permitted, are there any restrictions on what can be agreed? E.g. does the sum to be paid have to be a genuine pre-estimate of loss, or can the contractor be bound to pay a sum which is wholly unrelated to the amount of financial loss likely to be suffered by the employer? Will the courts in your jurisdiction ever look to revise an agreed rate of liquidated damages; and, if so, in what circumstances?

Yes, the parties to a construction contract are free to agree on a fixed amount of liquidated damages due to the employer when the contractor breaches the contract. The amount can be a percentage of the total contract price or the price for the work constituting the breach. However, the agreement is subject to certain legal

restrictions. First, the fixed amount cannot be used to cap any liability caused by intentional acts or gross negligence. Second, the court has discretion to cut the amount if it finds the amount disproportionately higher than the employer's actual loss.

3 Common Issues on Construction Contracts

3.1 Is the employer entitled to vary the works to be performed under the contract? Is there any limit on that right?

Yes, the employer is entitled to vary the works to be performed under the contract as long as the change is not significant. The law does not specify what constitutes significant change, but Article 22 of the GPA does forbid any contractual changes that would increase the contract price by more than 50%.

3.2 Can work be omitted from the contract? If it is omitted, can the employer carry out the omitted work himself or procure a third party to perform it?

Contractors are not allowed to omit work from the contract, but the employer can cancel part or all of the work under the contract. If the cancellation constitutes termination for convenience, the contractor can claim damages against the employer.

3.3 Are there terms which will/can be implied into a construction contract (e.g. a fitness for purpose obligation, or duty to act in good faith)?

General legal principles, such as duty to act in good faith, and/or common industry practices, are sometimes cited to interpret vague or conflicting terms in a construction contract. The legal principle or common practice applied varies from case to case.

3.4 If the contractor is delayed by two concurrent events, one the fault of the contractor and one the fault or risk of his employer, is the contractor entitled to: (a) an extension of time; and/or (b) the costs arising from that concurrent delay?

There is no statutory solution for delay by two concurrent events. In most cases, the contractor facing such a delay will be granted an extension of time. How long the construction term will be extended hinges on: (1) which event happened first; and (2) the percentage of responsibility to be borne by the contractor. In addition to the extension of time, a few employers will reimburse the contractors for their time-related costs during the extension.

3.5 Is there a time limit beyond which the parties to a construction contract may no longer bring claims against each other? How long is that period and when does time start to run?

There are numerous types of claim that may arise from a construction contract, and different claims are subject to different statutes of limitations. A contractor's payment claim against the employer is subject to a two-year time limit, which starts to run when the work is accepted. And while there are different types

of damages, a contractor's claim for damages enjoys a one-year or 15-year time limit, which starts when the cause of the damages manifests itself. As to the employer's defect claims, they are time-barred to one year after the defects are identified.

3.6 Which party usually bears the risk of unforeseen ground conditions under construction contracts in your jurisdiction?

Under Taiwan's construction contracts, the risk of unforeseeable ground conditions is usually borne by employers. Some turnkey contracts may shift the risk to the contractors, but they can often be covered by construction insurance policies, in whole or partially.

3.7 Which party usually bears the risk of a change in law affecting the completion of the works under construction contracts in your jurisdiction?

Nearly all construction contracts in Taiwan allocate the risk of legal changes to the employers. Where the law is changed to make completion of the work more difficult or impossible, the contractors are entitled to demand more construction time and/or payments, or to terminate the contract.

3.8 Which party usually owns the intellectual property in relation to the design and operation of the property?

In construction projects where government agencies are the employers, the intellectual property right for the work performed by the contractors is usually assigned to the employers through mutual agreement. Allowing the contractors to enjoy the intellectual property right is relatively rare.

3.9 Is the contractor ever entitled to suspend works?

No, the contractor has no right to suspend works under the contract. Under the Civil Code, the contractor's handover or completion of the works is a condition to payments from the employer, unless the employer's finances deteriorate after the signing of the contract.

3.10 Are there any grounds which automatically or usually entitle a party to terminate the contract? Are there any legal requirements as to how the terminating party's grounds for termination must be set out (e.g. in a termination notice)?

Under the Civil Code, an employer is free to terminate the construction contract at any time before the work is completed, but it has to compensate the contractor for any damage sustained from the termination. Also, if the work in a construction contract relies heavily on the contractor's skills, the contract should be deemed terminated when the contractor is deceased or no longer able to perform the work.

In construction contracts, one party is usually entitled to terminate the contract when the counterparty is in material breach. Where the contract is awarded by government agencies, the contractors usually have the right to terminate the contract if their work has been suspended for three consecutive months or more.

3.11 Do construction contracts in your jurisdiction commonly provide that the employer can terminate at any time and for any reason? If so, would an employer exercising that right need to pay the contractor's profit on the part of the works that remains unperformed as at termination?

Most construction contracts entitle employers to terminate the contract for convenience. Where a contract is terminated for causes unattributable to the contractors, under Article 511 of the Civil Code, the employers should compensate the contractors for their damage. The damage includes the costs and expected profit. But most contracts would exclude the interests the contractors are likely to gain for any work not yet performed at the time the contract is terminated.

3.12 Is the concept of *force majeure* or frustration known in your jurisdiction? What remedy does this give the affected party? Is it usual/possible to argue successfully that a contract which has become uneconomic is grounds for a claim for *force majeure*?

Yes, the concept of *force majeure* is recognised in Taiwan's construction contracts. In most cases, it is the contractors that will be affected by *force majeure* events. When an event of this kind occurs, a contractor is usually entitled to extensions of time and cost reimbursements.

Contracts that have subsequently become financially unviable cannot be grounds for a *force majeure* claim. However, the contractors may cite the doctrine of change of circumstances in the Civil Code to demand that the contract be terminated or the terms of the contract revised.

3.13 Are parties, who are not parties to the contract, entitled to claim the benefit of any contractual right which is made for their benefit? E.g. is the second or subsequent owner of a building able to claim against the contractor pursuant to the original construction contracts in relation to defects in the building?

No. A contract binds only the parties to it, and only the parties can claim rights derived from the contract. A third party is not entitled to any of the contractual rights, unless the contract specifies otherwise or a party to the contract transfers its right to the third party.

3.14 On construction and engineering projects in your jurisdiction, how common is the use of direct agreements or collateral warranties (i.e. agreements between the contractor and parties other than the employer with an interest in the project, e.g. funders, other stakeholders, and forward purchasers)?

In construction projects in Taiwan, direct agreements are commonly used, but collateral warranties are not.

3.15 Can one party (P1) to a construction contract, who owes money to the other (P2), set off against the sums due to P2 the sums P2 owes to P1? Are there any limits on the rights of set-off?

An employer is allowed to deduct the sum its contractor owes to it from the payment due to the contractor. However, in reality, most employers would make deductions of this kind cautiously

because the deductions may interrupt the contractors' cash flow, which is essential for the performance of the contract.

3.16 Do parties to construction contracts owe a duty of care to each other either in contract or under any other legal doctrine? If the duty of care is extra-contractual, can such duty exist concurrently with any contractual obligations and liabilities?

Yes, parties to construction contracts owe a duty of care to each other. The law does not specify the standard of care to which a contractor should adhere, but the prevailing court view is a contractor, being a professional, should exercise a higher level of care in performing the contract.

The duty of care is to decide which party should be held accountable for contractual breaches. A contractor will be held accountable if it fails to satisfy its duty of care and therefore breaches the contract. As to what liability the breaching contractor should bear, it depends on what the contract says.

3.17 Where the terms of a construction contract are ambiguous, are there rules which will settle how that ambiguity is interpreted?

In interpreting ambiguous terms in a contract, Article 98 of the Civil Code prioritises the parties' real intent over the literal meaning of the terms. According to the prevailing court view, the purpose and context of the contract, and earlier drafts of the terms, shall be considered in order to understand the parties' real intent.

3.18 Are there any terms which, if included in a construction contract, would be unenforceable?

Any terms that violate the statutory restrictions or bans, social order or morality will be deemed null and void. For example, a clause to shorten or waive the statute of limitations, or eliminate in advance liability caused by intentional acts or gross negligence, will be seen as invalid and unenforceable.

3.19 Where the construction contract involves an element of design and/or the contract is one for design only, are the designer's obligations absolute or are there limits on the extent of his liability? In particular, does the designer have to give an absolute guarantee in respect of his work?

The designer's obligation and the extent of his liability are solely determined by the contract, no matter what type of contract the designer enters into. The contract can set a limit on the designer's aggregate liability, but the limit becomes invalid if: (1) the liability is caused by the designer's intentional act or gross negligence; or (2) the liability is expressly excluded from the contractual limit.

3.20 Does the concept of decennial liability apply in your jurisdiction? If so, what is the nature of such liability and what is the scope of its application?

A concept similar to decennial liability exists in Taiwan. Under the Civil Code, an employer has one year to inspect the work after the work is completed or handed over to the employer. Where the work is construction on land or significant repair of

construction, the inspection period is extended to five years. The inspection period can be further extended to five years and 10 years respectively if the contractor is found to have deliberately concealed work defects from the employer.

4 Dispute Resolution

4.1 How are construction disputes generally resolved?

In Taiwan, construction disputes are usually resolved through: (1) amicable negotiation between the parties; (2) mediation by the PCC or the court; (3) litigation; or (4) arbitration with the parties' consent. If PCC mediation founders owing to the employer's rejection of the PCC's mediation proposal, Article 85-1 of the GPA entitles the contractor to apply for arbitration without the employer's consent.

4.2 Do you have adjudication processes in your jurisdiction (whether statutory or otherwise) or any other forms of interim dispute resolution (e.g. a dispute review board)? If so, please describe the general procedures.

A dispute review board and a dispute adjudication board were once discussed but ultimately not adopted in Taiwan.

4.3 Do the construction contracts in your jurisdiction commonly have arbitration clauses? If so, please explain how, in general terms, arbitration works in your jurisdiction.

No, arbitration clauses are rarely seen in Taiwan's construction contracts nowadays. If contractors would like to have their construction dispute arbitrated, they will need to seek consent from their employer or subject the employer to mandatory arbitration under Article 85-1 of the GPA.

4.4 Where the contract provides for international arbitration, do your jurisdiction's courts recognise and enforce international arbitration awards? Please advise of any obstacles (legal or practical) to enforcement.

Yes, international arbitration awards are recognised and enforceable in Taiwan unless: (1) the recognition or enforcement of the awards would defy Taiwan's social order or morality; (2) the

disputes arbitrated cannot be resolved by arbitration under Taiwan law; or (3) the countries where the awards are rendered or whose laws are applied do not recognise Taiwan's arbitration awards.

4.5 Where a contract provides for court proceedings in your jurisdiction, please outline the process adopted, any rights of appeal and a general assessment of how long proceedings are likely to take to reduce: (a) a decision by the court of first jurisdiction; and (b) a decision by the final court of appeal.

The court system in Taiwan can be divided into three levels: the district court; the high court; and the Supreme Court. Any party who loses the district court trial is free to lodge an appeal to the high court, but only claims exceeding NT\$1.5 million can be brought to the Supreme Court. The trial time for each instance can last from less than a year to more than five years, depending on the complexity of the dispute, but overall it will take the court longer to adjudicate on construction disputes.

4.6 Where the contract provides for court proceedings in a foreign country, will the judgment of that foreign court be upheld and enforced in your jurisdiction? If the answer depends on the foreign country in question, are there any foreign countries in respect of which enforcement is more straightforward (whether as a result of international treaties or otherwise)?

Yes, foreign court decisions will be upheld and enforced in Taiwan unless: (1) the foreign court had no jurisdiction to render the decision; (2) the defendant losing the suit did not attend the hearings because of illegal service; (3) the reasoning of the decision or the legal proceedings defy Taiwan's social order or morality; or (4) the foreign country does not recognise Taiwanese court decisions.



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1 Making Construction Projects

1.1 What are the standard types of construction contract in your jurisdiction? Do you have: (i) any contracts which place both design and construction obligations upon contractors; (ii) any forms of design-only contract; and/or (iii) any arrangement known as management contracting, with one main managing contractor and with the construction work done by a series of package contractors? (NB For ease of reference throughout the chapter, we refer to “construction contracts” as an abbreviation for construction and engineering contracts.)

With its 50 separate states, the United States offers a wide variety of contract types. Before the 1980s, there was a general preference for fixed-price design-bid-build contracts, based on an employer advertising a fully completed set of design documents. Time-and-materials arrangements have also long been used, especially where it is difficult to estimate a fixed price or when construction must begin before there is time to complete a design. In recent decades, however, statutory changes have facilitated a much increased use of design-build contracting and its variations such as engineer-procure-construct (EPC) contracting. The evolving technologies used in construction have led to an increased use of design-build contracting in specialty trades. Although public-private partnerships (P3) and Integrated Project Delivery (IPD) have had a relatively slow start in the United States, their use seems to be gradually increasing. Nonetheless, many segments of the U.S. construction industry remain largely unfamiliar with those project delivery systems. On IPD, *see* Bruner & O’Connor on Constr. Law, §6.18.10 *et seq.* (2020).

There is no standard form of construction agreement in the United States. The contract forms provided by the International Federation of Consulting Engineers (FIDIC) are rarely if ever used. Federal construction projects are generally governed by the Federal Acquisition Regulation (FAR), a book containing numerous clauses mandated on various types of jobs. On local government projects and private construction, the A-201 General Conditions and other forms published by the American Institute of Architects (AIA) are probably the most widely used. Other well-known suites of contract forms are published by ConsensusDocs, the Engineers Joint Contract Documents Committee (EJCDC) and the Design-Build Institute of America (DBIA). All of these forms make an effort to achieve a degree of balance between the various parties that typically participate in a complex construction project, although that balance can easily be lost when the forms are heavily modified to favour the interests of a particular party.

In the U.S., construction management contracting is typically handled by a construction manager. Some of them (“at risk”) also hold direct agreements with trade contractors, while others (“not at risk”) merely ask as advisors to an employer (usually referred to as the “owner” in the U.S.).

1.2 How prevalent is collaborative contracting (e.g. alliance contracting and partnering) in your jurisdiction? To the extent applicable, what forms of collaborative contracts are commonly used?

On design-build or P3 projects, contractors commonly partner with design firms, either through a joint venture agreement or conventional subcontracting. On large civil projects, it is also common for two or more general contractors to bid for the work together, either as a temporary alliance team or a formal joint venture entity. *See, e.g.*, ConsensusDocs 298.

1.3 What industry standard forms of construction contract are most commonly used in your jurisdiction?

See answer to question 1.1 above.

1.4 What (if any) legal requirements are there to create a legally binding contract (e.g. in common law jurisdictions, offer, acceptance, consideration and intention to create legal relations are usually required)? Are there any mandatory law requirements which need to be reflected in a construction contract (e.g. provision for adjudication or any need for the contract to be evidenced in writing)?

Although U.S. states are generally common law jurisdictions, some of them (e.g., California and Louisiana) have adopted civil codes that include many principles applicable to construction law. Purchase of equipment and other goods is typically governed by the Uniform Commercial Code (UCC), which provides rules for sales, security interests, warranties and remedies when those terms are not specified by contract. Where a state lacks applicable case law on a particular subject, its courts often look to federal case law or to decisions in neighbouring states.

Under U.S. common law, a binding contract typically requires an offer, acceptance, and economic consideration. Consideration can be very minimal (including the mere exchange of reciprocal obligations). Most requests for proposals are written as invitations for tenders, so that they do not constitute offers in themselves. Employers typically treat the tenders as offers and try to reserve broad discretion in deciding which one (if any) to accept.

The individual states have various requirements as to which kinds of contract must be in writing to be valid (so-called “statutes of frauds”). Some terms can be implied from industry practice or from previous dealings between the parties. On some facts, acceptance may be inferred where an employer allows work to proceed without a signed agreement. However, if the evidence indicates no “meeting of the minds” with regard to essential contract terms, a binding contract is unlikely to exist. Even without a written agreement, a contractor may have an equitable right to payment if it performs work in good-faith reliance on what it reasonably understood as an employer’s offer to contract (e.g., implied contract, quasi-contract, *quantum meruit*, and equitable estoppel).

1.5 In your jurisdiction please identify whether there is a concept of what is known as a “letter of intent”, in which an employer can give either a legally binding or non-legally binding indication of willingness either to enter into a contract later or to commit itself to meet certain costs to be incurred by the contractor whether or not a full contract is ever concluded.

Enforceability of agreements is likely to depend more on their substance than on their form. A letter of intent may be unenforceable if it is nothing more than an agreement to agree. It is not uncommon, however, for parties to enter what they intend as a binding “memorandum of understanding” or “memorandum of agreement”, while leaving details for later negotiation. It is also common for employers to issue a limited notice to proceed or execute a limited-scope agreement that allows certain preliminary and/or long-lead activities to begin while the parties continue negotiating to price the balance of the planned project.

1.6 Are there any statutory or standard types of insurance which it would be commonplace or compulsory to have in place when carrying out construction work? For example, is there employer’s liability insurance for contractors in respect of death and personal injury, or is there a requirement for the contractor to have contractors’ all-risk insurance?

Applicable statutes generally require contractors to hold a licence in the state where work is done, and such licences usually mandate some level of insurance. There are many insurance products and insurance approaches available. Employers typically require contractors to provide coverage for general liability and excess liability, which covers at least personal injury, death and property damage. Applicable laws also typically require insurance for losses caused by automobiles and for workers’ compensation. Contracts including design responsibility are likely to require professional liability insurance. It is also common to require insurance against environmental pollution and coverage for completed operations. Employers often procure builder’s risk or all-risk insurance covering damage to the project as it is constructed. On some jobs, prime contractors may purchase insurance against defaults by lower-tier contractors.

To avoid the cost associated with multiple tiers of contractors procuring overlapping policies, it is common for projects to have a single consolidated Contractor Controlled Insurance Program (CCIP) or Owner Controlled Insurance Program (OCIP).

1.7 Are there any statutory requirements in relation to construction contracts in terms of: (a) labour (i.e. the legal status of those working on site as employees or as self-employed sub-contractors); (b) tax (payment of income tax of employees); and/or (c) health and safety?

- (a) In the U.S., labour relations between workers and employers are primarily governed by federal statutes and regulations, creating substantial uniformity between the states. The Immigration Reform and Control Act of 1986 prohibits the knowing hire of workers who lack legal status to work in the U.S. Other laws prohibit discrimination, such as Title VII of the Civil Rights Act, the Age Discrimination in Employment Act, and the Americans with Disabilities Act. Minimum wage rates are established by the Wage Rates Requirements (formerly under the Davis-Bacon Act) and other laws, as are rules for paying premiums for overtime labour. Separate union agreements often govern the benefits that must be paid to construction workers or to their labour unions.
- (b) In the U.S., most taxes are assessed either by the federal government or by the individual states. Contractors must usually withhold sums from worker compensation to assure payment of applicable taxes and employee benefits. State tax rates vary considerably. There is no federal sales tax or VAT, but most states charge sales and excise taxes that apply to many construction projects. The federal government charges income tax on individuals, as do most state governments. The federal government also charges a corporate income tax, although it was substantially reduced in 2018. The federal government also charges taxes to support Social Security (retirement), Medicare (medical care for seniors), and unemployment insurance.
- (c) Health and safety are heavily regulated, both at a federal and state level. The federal Occupational Safety and Health Act (OSHA) and its implementing regulations are probably the best-known. Individual states have their own occupational safety laws, and the federal Jones Act has specific remedies for injuries occurring during work on a ship or barge.

1.8 Is the employer legally permitted to retain part of the purchase price for the works as a retention to be released either in whole or in part when: (a) the works are substantially complete; and/or (b) any agreed defects liability period is complete?

U.S. employers are generally entitled to withhold a portion of a contractor’s price as security for final completion of a construction project. Such withholding must be authorised by contract, and it is typically in the range of 5% to 10% of the contract price. Many contracts provide that the percentage of retention declines after the work is at least 50% complete, and it is often possible for the contractor to obtain release of the retention balance by posting a special bond as substitute security for the employer. It is not common to allow retention after final completion, e.g., as security for performance of post-completion warranty claims that have not yet arisen. For specialty contractors performing early stages of work (e.g., foundations, shoring, or ground improvement), it is common to provide for release of their retention when their work is done, rather than holding back money until a much later date when the rest of the project is completed.

1.9 Is it permissible/common for there to be performance bonds (provided by banks and others) to guarantee the contractor's performance? Are there any restrictions on the nature of such bonds? Are there any grounds on which a call on such bonds may be restrained (e.g. by interim injunction); and, if so, how often is such relief generally granted in your jurisdiction? Would such bonds typically provide for payment on demand (without pre-condition) or only upon default of the contractor?

Performance bonds are commonly used in the United States, and most contractors have established relationships with surety companies that provide bonding when necessary. Banks are not typically involved in providing performance bonds, and letters of credit are much less common as project security than in many other countries. U.S. employers also typically require payment bonds (like the “Miller Act” bonds on federal contracts and the similar “little Miller Act” bonds on state contracts). Forms of bond are generally not prescribed by law, although some forms (like the ones published by the AIA) are widely used.

1.10 Is it permissible/common for there to be company guarantees provided to guarantee the performance of subsidiary companies? Are there any restrictions on the nature of such guarantees?

When the successful tenderer is a new joint venture entity or a specially formed project company, it is not unusual for the employer to require guarantees from the parent companies, and U.S. law will not substantially restrict the nature of such guarantees. On most projects, however, the employer relies on bonds and retention as the principal guarantees of contractor performance. Parent guarantees are particularly likely on contracts (e.g., P3) with long-term project operating responsibilities.

1.11 Is it possible and/or usual for contractors to have retention of title rights in relation to goods and supplies used in the works? Is it permissible for contractors to claim that, until they have been paid, they retain title and the right to remove goods and materials supplied from the site?

If a commercial contract is silent as to ownership of delivered materials and equipment, the contractor's ownership rights in those “goods” are likely to be governed by the Uniform Commercial Code, which includes a mechanism for establishing security interests in delivered products until the employer pays for them. On most commercial projects, however, contracts provide that title passes upon installation (or even earlier, when goods are delivered and paid for). Contracts often provide that employers may take over the materials purchased by a defaulting contractor as needed to complete the job. The contractor's right to payment is generally protected by statutory lien rights in the improved property, or by some form of payment bond.

2 Supervising Construction Contracts

2.1 Is it common for construction contracts to be supervised on behalf of the employer by a third party (e.g. an engineer)? Does any such third party have a duty to act impartially between the contractor and the employer? If so, what is the nature of such duty (e.g. is it absolute or qualified)? What (if any) recourse does a party to a construction contract have in the event that the third party breaches such duty?

Relatively few employers have sufficient in-house experience to manage a complex construction project with their own personnel. Therefore, they often hire a construction manager for that purpose. Construction managers typically do not owe a duty to act impartially between employer and contractor. Where the employer retains its architect to perform this role, however, the architect may be bound to act impartially by contract or by Rule 2.4 of the National Council of Architectural Boards (or similar provisions in state codes of professional responsibility for architects).

2.2 Are employers free to provide in the contract that they will pay the contractor when they, the employer, have themselves been paid; i.e. can the employer include in the contract what is known as a “pay when paid” clause?

Subcontracts often provide that the employer's prime contract payments are a “condition precedent” for lower-tier contractors getting paid (“pay if paid”), and it is also common to see clauses indicating that lower-tier contractors should wait to get paid after the prime contractor is paid (“pay when paid”). The enforceability of “pay if paid” clauses was challenged successfully in California on the theory that it conflicted with statutory lien rights. *Wm. R. Clarke Corp. v. Safeco Ins. Co.*, 15 Cal. 4th 882, 938 P.2d 372, 64 Cal.Rptr.2d 578 (1997). Many state courts have not yet specifically addressed this issue, but they are likely to hold that a subcontractor may at least be required to wait for a reasonable time while the prime contractor pursues payment from the employer on the subcontractor's behalf.

In federal contracts, FAR 52.232.27 generally requires prime contractors to pass progress payments through to subcontractors within seven days after receiving money from the government. State governments generally have similar “prompt payment” statutes for their own projects.

2.3 Are the parties free to agree in advance a fixed sum (known as liquidated damages) which will be paid by the contractor to the employer in the event of particular breaches, e.g. liquidated damages for late completion? If such arrangements are permitted, are there any restrictions on what can be agreed? E.g. does the sum to be paid have to be a genuine pre-estimate of loss, or can the contractor be bound to pay a sum which is wholly unrelated to the amount of financial loss likely to be suffered by the employer? Will the courts in your jurisdiction ever look to revise an agreed rate of liquidated damages; and, if so, in what circumstances?

Liquidated damages are widely used on U.S. projects to determine the price that a contractor will pay for unexcused delays in completing its work, especially where it will be difficult to forecast the employer's resulting financial damages. When likely delay costs are unusually high (e.g., from high-revenue-producing facilities like power plants and casinos), liquidated delay damages are also used to cap monetary liability for delay because it would be difficult to attract fixed-price tenders without such assurances. Employers will generally be unable to enforce liquidated damages that are held to be a penalty, i.e. that do not represent a reasonable forecast of fair compensation for anticipated delay-related costs. The reasonableness of liquidated damages is typically determined as of the time of contracting, rather than later when a breach occurs. Liquidated damages are usually not recoverable by an employer who has caused concurrent delays during the time period at issue.

Liquidated damages are also used to determine contractor liability for other types of breaches. On power plants, for example, liquidated damages are typically used to limit liability based on failure to achieve key performance guarantees such as heat rate and overall power output.

When a prime contract fixes the amount(s) of monetary damages for delay or for some other breach, those damage rates typically preclude a separate claim for “actual” damages arising from the same breach.

3 Common Issues on Construction Contracts

3.1 Is the employer entitled to vary the works to be performed under the contract? Is there any limit on that right?

Almost every construction contract contains language giving the employer a right to increase or decrease the contractor’s scope of work by issuing a written variation, normally called a “change order” in the U.S. Where the parties cannot agree on such a variation, employers often reserve a right to issue a unilateral directive to perform the variation. There are, however, normally some limits on this power. If it fundamentally changes the nature or scope of work, it may be treated as a “cardinal change”, i.e. essentially a breach of contract by the employer. A major deletion may also be treated as a partial termination for convenience rather than a deductive change, which may affect the mechanism used to price the adjustment. Variations normally have to be exercised in good faith, and an employer may be constrained from inviting tenders on a broad scope of work and later using deductive changes to remove only the easiest or most profitable portions of the scope.

3.2 Can work be omitted from the contract? If it is omitted, can the employer carry out the omitted work himself or procure a third party to perform it?

Where an item of work is unintentionally omitted from a contract (e.g., a “scope gap”), employers may typically add it by issuing a variation (*see* question 3.1 above). Alternatively, the employer may generally perform the omitted work with its own forces or with another prime contractor. On power plants and other major infrastructure, it is common for employers to supply some of the major long-lead equipment themselves, in part to expedite the schedule and also to avoid paying mark-ups to the installing contractor. In some cases, union agreements may restrict the ability of the employer to use its own labour on site.

3.3 Are there terms which will/can be implied into a construction contract (e.g. a fitness for purpose obligation, or duty to act in good faith)?

In the U.S., every contract party owes an implied duty of good faith and fair dealing. As a corollary to this duty, parties are typically held to owe an implied duty that they will not hinder or delay each other.

An employer who provides plans and specifications for use in construction impliedly warrants that they are suitable for use, and employers are typically held responsible for errors and omissions in their contract documents unless the contractor assumes responsibility for reviewing and completing the design as a design-builder (and even in that case the contractor may be able

to place some degree of reliance on the employer’s partial design and/or site information).

Many courts have held that an employer owes an implied duty to disclose any non-public “superior knowledge” about the site or the project that a court finds should have been disclosed to the contractor.

When furnishing materials or equipment for a construction project, the seller typically owes implied duties that the goods will be of “merchantable” quality and that they will be reasonably fit for their intended purposes. *See* U.C.C. §2-314, 315. Such implied warranties may, however, effectively be disclaimed by contract.

State statutes may provide that home builders owe an implied duty that the resulting residences meet certain standards for “habitability”.

In construction service agreements, contractors are generally held to an implied duty that they will perform in a “good and workmanlike” manner. And in design contracts, architects and engineers may be held to an implied obligation to perform to the “prevailing standard” established for similar services in the area where the work is done.

In multi-prime contracts, employers may owe an implied duty to coordinate their various prime contracts, and prime contractors will probably be held to an implied duty to coordinate their various subcontractors and suppliers.

3.4 If the contractor is delayed by two concurrent events, one the fault of the contractor and one the fault or risk of his employer, is the contractor entitled to: (a) an extension of time; and/or (b) the costs arising from that concurrent delay?

If the delays are truly concurrent and cannot be segregated, the most common approach is that neither party may recover monetary delay damages from the other party during the period when both of them were independently causing delay. In some cases, however, courts and arbitrators will make an effort to apportion delay costs between the two parties.

If a party can show that it slowed parts of its work after realising that the job was already being delayed by the other party, it may overcome the concurrent delay defence.

3.5 Is there a time limit beyond which the parties to a construction contract may no longer bring claims against each other? How long is that period and when does time start to run?

State laws typically include a “statute of repose”, setting the number of years in which a construction-related claim must accrue (i.e. the time in which they must generally be discovered). After a claim has accrued, states have separate statutes of limitation that define the number of years in which the discovered claim must be filed (in court or arbitration).

Some construction contracts and agreements with insurers or sureties will specify shorter time limits for making claims than the periods allowed under state statutes. Many construction contracts specify that contractor claims need to be asserted before accepting final payment from the employer.

3.6 Which party usually bears the risk of unforeseen ground conditions under construction contracts in your jurisdiction?

Most U.S. commercial construction contracts assign the risk of unforeseen subsurface conditions to the employer, assuming that

the employer normally has more time and opportunity to study the ground that will be excavated. This is typically handled by a Differing Site Conditions clause. *See, e.g.*, FAR 52.236-2. Such clauses typically allow compensation if a contractor encounters latent site conditions that differ materially from those indicated in the contract documents (“type 1”) or latent conditions of an unusual nature that would not normally be expected in the type of ground at issue (“type 2”). Contractors must usually give prompt notice of such conditions and should take reasonable steps to mitigate their impacts. Contractor rights to claim Differing Site Conditions may be limited if the contractor is paid to conduct its own independent pre-bid investigation of subsurface conditions or if a particular contractor had knowledge of the condition based on prior work at the site.

3.7 Which party usually bears the risk of a change in law affecting the completion of the works under construction contracts in your jurisdiction?

The risk of unforeseen post-tender changes in laws, regulations or building codes is often allocated by contract. The AIA General Conditions typically assign responsibility to the employer, except for legal changes that were already known or foreseeable when tenders were submitted. This issue became a source of much dispute when state laws imposed major temporary restrictions on construction during the 2020 COVID-19 pandemic.

3.8 Which party usually owns the intellectual property in relation to the design and operation of the property?

Many contracts treat project-specific design as “work for hire” that belongs to the employer. Absent a contract clause to the contrary, an architect probably has copyright protection for its plans, drawings and other design work product as stated in the Architectural Works Copyright Protection Act of 1990. In negotiated contracts, designers often retain ownership but grant a royalty-free perpetual licence to the employer and its successors for use on the project site.

3.9 Is the contractor ever entitled to suspend works?

Under U.S. common law, contractors generally have a right to suspend based on an uncured material breach by the employer (e.g., failure to make progress payments). Such rights are, however, often restricted by contract and should be exercised only after giving written notice and opportunity to cure. On federal projects, a contractor must generally proceed unless the government contracting officer has ordered a cardinal change (i.e. a substantially different or larger scope than originally awarded). Contracts often require work to proceed despite a pending dispute, e.g., regarding compensation for an employer variation.

Other circumstances that may justify a contractor’s temporary suspension of work may include an employer’s failure to provide permits or site access, discovery of unforeseen hazardous materials in the ground that impede progress, the employer’s failure to make key required decisions (e.g., approving submittals), encountering unexpected archaeological remains, or other unanticipated *force majeure* events outside the contractor’s reasonable control.

3.10 Are there any grounds which automatically or usually entitle a party to terminate the contract? Are there any legal requirements as to how the terminating party’s grounds for termination must be set out (e.g. in a termination notice)?

Employer-drafted contracts sometimes provide that contracts are automatically terminated if the contractor files for bankruptcy protection, although such rights are likely to be limited by federal law. Contracts typically authorise termination for default, however, only if a party fails to cure a breach within a specified time after receiving written notice from the other party. Underlying defaults most often include failure to: make required payments; prosecute work; correct defects; provide required bonds or insurance; and provide essential permits or site access.

3.11 Do construction contracts in your jurisdiction commonly provide that the employer can terminate at any time and for any reason? If so, would an employer exercising that right need to pay the contractor’s profit on the part of the works that remains unperformed as at termination?

U.S. construction contracts often allow employers and prime contractors to terminate lower-tier agreements “for convenience” at any time. Such rights must generally be reserved by contract because they do not arise from common law. Applicable clauses usually provide that a terminated contractor may not recover profit that would have been earned on the unperformed balance of the work.

3.12 Is the concept of *force majeure* or frustration known in your jurisdiction? What remedy does this give the affected party? Is it usual/possible to argue successfully that a contract which has become uneconomic is grounds for a claim for *force majeure*?

The concept of *force majeure* is well known in U.S. construction contracting. Although some contracts allow compensation to a contractor whose progress is interrupted by such unexpected events, most contracts merely allow only an uncompensated extension of time. *Force majeure* events are typically defined to include only unforeseen events outside the control of both contract parties, and labour strikes may be excluded from this category if they arise from specific acts or omissions of the affected contractor (i.e. to be distinguished from national or regional strikes). The fact that a project becomes more difficult or costly due to rising costs of labour or materials is generally not regarded as a *force majeure* condition, although courts may regard sudden and extreme price escalations in this category. Many U.S. employers have argued that the COVID-19 pandemic is a *force majeure* event for which no resulting costs are recoverable, but contractors counter that claims for changes in work and lost efficiency are compensable even if pure delay costs are not.

In some limited cases, performance may also be excused (i.e. effectively allowing its termination) on *force majeure* principles if the contractor can show that the specified work was frustrated by impossibility or commercial impracticability.

3.13 Are parties, who are not parties to the contract, entitled to claim the benefit of any contractual right which is made for their benefit? E.g. is the second or subsequent owner of a building able to claim against the contractor pursuant to the original construction contracts in relation to defects in the building?

Under U.S. common law, third parties may possess rights under agreements between two other parties if such rights were clearly intended. For example, a prime contractor may effectively require a subcontractor to indemnify the employer for third-party claims based on errors in the subcontractor's work. Warranties on special materials and on installed equipment are often set up to flow directly from the manufacturer or supplier to the end customer. Lenders and employers may require subcontracts to be assignable to them if the prime contractor defaults on its obligations. Residential developers generally require builders to make direct warranties to purchasers of new homes. Alternatively, residential purchasers may have rights against contractors based on tort law or state statute.

3.14 On construction and engineering projects in your jurisdiction, how common is the use of direct agreements or collateral warranties (i.e. agreements between the contractor and parties other than the employer with an interest in the project, e.g. funders, other stakeholders, and forward purchasers)?

Collateral warranty is not a familiar term in U.S. construction law, although many warranties from sub-tier parties run directly to employers, and contracts often provide that warranties may be assigned by the employer. Also, contractor indemnity clauses often protect both the employer and its engineer(s).

3.15 Can one party (P1) to a construction contract, who owes money to the other (P2), set off against the sums due to P2 the sums P2 owes to P1? Are there any limits on the rights of set-off?

It is generally understood that a party's payment obligations on a particular contract may be set off against monetary obligations owed by the payee under the same contract (e.g., progress payments being withheld to pay costs of curing defective work). U.S. common law may also allow an employer to withhold payments based on sums owed by the payee on a separate project.

Common law rights of set-off may be limited by contract if not by law. For example, contracts commonly provide that the employer's progress payments should be treated as a "trust fund" in favour of persons providing labour or materials on the job, which is inconsistent with the idea of diverting the funds to pay one of the contractor's obligations on another job.

A prime contractor's power to withhold money from a subcontractor based on debts on another job may also be limited by an applicable "prompt payment" statute.

3.16 Do parties to construction contracts owe a duty of care to each other either in contract or under any other legal doctrine? If the duty of care is extra-contractual, can such duty exist concurrently with any contractual obligations and liabilities?

Obligations generally arise either by contract, or in tort, or by statute. With regard to implied obligations, *see* answer to question 3.3 above.

3.17 Where the terms of a construction contract are ambiguous, are there rules which will settle how that ambiguity is interpreted?

Following the principle of *contra proferentem*, U.S. courts often tend to construe ambiguous contract terms against the party who wrote them. Normally, an ambiguity only exists if it is reasonably susceptible to at least two alternative meanings. Once a clause is found to be ambiguous, courts in most states may consider evidence outside the written contract ("parol evidence") to assist in interpretation. For example, courts often look at the parties' course of performance before a dispute arose, common understanding of certain terms in the construction industry, a desire to give meaning to every term, and a desire to avoid interpretations that result in an inequitable forfeiture by one party. Some states may also allow the use of parol evidence to help clarify (but not flatly contradict) a written contract even if it does not immediately seem ambiguous on its face.

Many contracts seek to minimise ambiguities by establishing an "order of precedence" that can be applied if various contract documents are found to be inconsistent. Some contracts also require the contractor to review the various documents and provide prompt written notice if and when conflicts or ambiguities are discovered.

3.18 Are there any terms which, if included in a construction contract, would be unenforceable?

As discussed elsewhere in these answers, a number of commercial terms are unenforceable or void in U.S. construction contracts. The unenforceability may result from a statute or from common law case decisions. The invalid clauses will vary from one state to another.

Terms that tend not to be enforced include: a) requirements to indemnify another party against its own fault; b) clauses requiring waiver of fundamental rights guaranteed by constitutions or statutes; c) pre-construction waivers of statutory lien rights; d) liquidated delay damages set higher than the contractee's reasonably anticipated damages; e) damages precluding one party from recovering any damages for delays or breaches by the other party; f) "pay if paid" clauses making a subcontractor's payments absolutely conditional on corresponding payments from the employer to the prime contractor; and g) clauses that violate any other law or public policy.

3.19 Where the construction contract involves an element of design and/or the contract is one for design only, are the designer's obligations absolute or are there limits on the extent of his liability? In particular, does the designer have to give an absolute guarantee in respect of his work?

Although some design contracts attempt to impose a standard of defect-free design, most designers will insist on applying the common law standard under which claims of professional negligence require proof that the defendant violated the prevailing standard of professional care for comparable services. That prevailing standard clearly allows for some level of error or imperfection, and cases alleging professional negligence typically require evidence from a licensed professional who can explain how prevailing standards apply to the facts. Design contracts often specify that the designer will correct errors in design at its own cost, but designers will generally not agree to an unqualified guarantee that their work is free of defects. Design

contracts also typically include an aggregate cap on monetary liability for breach of contract by the design professional.

3.20 Does the concept of decennial liability apply in your jurisdiction? If so, what is the nature of such liability and what is the scope of its application?

U.S. law generally has no direct counterpart to “decennial liability” of the sort required in France and some other civil law countries. Approximately half of the states, however, have long statutes of repose that can create a risk of liability for latent defects discovered many years after substantial completion of a construction project. *See, e.g., California Civil Code §895.*

4 Dispute Resolution

4.1 How are construction disputes generally resolved?

Under a federal government contract, disputes are ultimately subject to resolution in a federal court or agency board, without a jury. Under state, local or private contracts, disputes are ultimately subject to resolution in a court (often with a right to jury) unless the parties have agreed otherwise. Although some federal agency boards have significant experience in construction disputes, most courts have little such experience, and parties often agree by contract that disputes will be referred to mediation and ultimately to binding arbitration by a person with construction industry expertise.

Many contracts initially refer disputes to high-level executives of the parties before they may be submitted to a court or arbitration panel. Many large complex projects also establish a Dispute Review Board that helps to resolve issues while the job is being performed. Non-binding mediation is also very commonly used to resolve complex construction disputes.

A number of companies provide mediation and arbitration services. Two of the largest providers are the American Arbitration Association (AAA) and JAMS, each of which publishes detailed rules for mediation and arbitration.

4.2 Do you have adjudication processes in your jurisdiction (whether statutory or otherwise) or any other forms of interim dispute resolution (e.g. a dispute review board)? If so, please describe the general procedures.

The U.S. has not yet adopted “adjudication” of the kind that is now widely used in the United Kingdom. On large complex projects, however, many contracts require submission of disputes to a Dispute Review Board (DRB), typically a panel of three individuals who have substantial construction industry experience. Although DRB recommendations are usually subject to appeal, they resolve many issues and are often given considerable deference.

4.3 Do the construction contracts in your jurisdiction commonly have arbitration clauses? If so, please explain how, in general terms, arbitration works in your jurisdiction.

Many of the most widely used construction contract forms provide for mediation and ultimately for binding arbitration as a means of resolving construction disputes, especially on private projects. Arbitration is generally not, however, an available remedy under federal government construction contracts. Where an unpaid contractor or supplier seeks to enforce security

rights against real property (e.g., under a statutory lien), that lien foreclosure action must generally be prosecuted in a court.

Arbitration is typically commenced when a claimant files a demand for arbitration with the administrative entity in charge of handling the arbitration. The respondent may answer in detail (and may serve a counterclaim), and its failure to do so will generally be treated as a denial of the claims asserted. Responding parties may also assert cross-claims against third parties who have consented to arbitration. The arbitral administrator may assess filing fees based on published rates, and parties will generally be required to deposit sufficient additional funds to cover the expected charges of the arbitrator(s). Unlike international arbitration, domestic arbitrations in the U.S. generally allow at least a limited number of depositions, although pre-hearing discovery tends to be more limited in arbitrations than in courts.

Courts give considerable deference to arbitration. Arbitral awards are generally final and enforced in the U.S., although statutes allow very limited appeals in extraordinary cases (e.g., arbitrators who fail to disclose conflicts, going beyond the parties’ contractual submission to arbitration, obvious partiality, or fundamental denial of due process).

4.4 Where the contract provides for international arbitration, do your jurisdiction’s courts recognise and enforce international arbitration awards? Please advise of any obstacles (legal or practical) to enforcement.

The United States is a signatory nation to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the “New York Convention”), and the U.S. complies with this agreement by enforcing arbitral agreements and awards issued in signatory countries. Consistent with Article V of the New York Convention, defences to enforcement of a foreign award include lack of due process, a conclusion that enforcement would be contrary to public policy, and other listed defences.

Chapter 2 of the Federal Arbitration Act provides terms under which courts of the United States shall enforce foreign arbitration awards in accordance with the New York Convention.

4.5 Where a contract provides for court proceedings in your jurisdiction, please outline the process adopted, any rights of appeal and a general assessment of how long proceedings are likely to take to reduce: (a) a decision by the court of first jurisdiction; and (b) a decision by the final court of appeal.

Federal courts typically allow jurisdiction only to limited categories of cases (e.g., claims for damages over \$75,000 between parties located in different states). State trial courts exercise broader jurisdiction, extending to all parties doing business within their borders. Parties in courts are often entitled to demand use of a jury.

Court actions typically begin by filing a written “complaint” identifying parties, key facts, and basic legal claims. Defendants are generally required to file a written “answer” to the complaint, and the answer may also assert one or more counterclaims. A responding party may also assert cross-claims against third parties who are subject to the court’s jurisdiction.

After the parties’ initial exchange of written positions, they are typically required to exchange relevant documents and produce witnesses for pre-hearing oral examination (depositions). Parties are also generally allowed to require opposing parties to answer a limited number of written questions (interrogatories). Discovery in a U.S. court is usually much more extensive than would be allowed in an international arbitration or litigation.

The delay between filing of a case and commencement of the hearing will vary significantly from one jurisdiction to another. Some courts have much heavier schedules than others, and a long backlog can delay the scheduling of a hearing. Larger cases with more witnesses and complex issues are likely to experience significantly longer delays in getting a trial date. In most cases, however, a hearing can be set between one and two years after a complaint is filed. Depending on the jurisdiction, it can then take several months or years to receive a decision.

U.S. court rules allow for purely legal issues to be resolved prior to trial, under what is called a summary judgment motion.

4.6 Where the contract provides for court proceedings in a foreign country, will the judgment of that foreign court be upheld and enforced in your jurisdiction? If the answer depends on the foreign country in question, are there any foreign countries in respect of which enforcement is more straightforward (whether as a result of international treaties or otherwise)?

The United States has not signed any general agreement to enforce foreign court judgments that would be equivalent to enforcement of foreign arbitral awards under the New York Convention.

The Federal Arbitration Act also contains no general requirement that U.S. courts must recognise a foreign court judgment. Several states have nonetheless adopted the 2005 Uniform Foreign Money-Judgments Recognition Act, which sets forth criteria under which signatory states agree to enforce judgments from foreign courts. As under the New York Convention, principal concerns are assuring that the foreign proceeding allowed due process and that its ultimate judgment does not violate U.S. public policy. However, U.S. courts are likely to give reasonable deference to judgments rendered by courts in other countries that have signed the New York Convention, and the U.S. has bilateral agreements with various countries that facilitate enforcement of foreign judgments and awards.

Some individual states have their own bilateral agreements with other jurisdictions that facilitate enforcement of court judgments. *See* the 1962 Uniform Foreign Money-Judgments Recognition Act and the 2005 Uniform Foreign-Country Money Recognition Act, which have been adopted in 23 states and the District of Columbia.



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- American College of Construction Lawyers: national President (2018–19).
- Best Lawyers in America: selected.
- Canadian College of Construction Lawyers: Honorary Fellow.
- Chartered Institute of Arbitrators: Fellow.
- International Academy of Construction Lawyers: Fellow & Treasurer.
- International Bar Association, International Construction Projects Committee: Vice Chair of Project Execution Committee and panel speaker at conferences in Australia, Austria, Germany, Greece, and the Netherlands.
- Society of Construction Law: Program Coordinator 2008 (London), 2010 (Hong Kong), 2012 (Melbourne), 2014 (Kuala Lumpur), 2016 (São Paulo), and 2018 (Chicago).

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Mr. Oles has written or contributed to numerous books and articles on construction law. The most recent include: *Construction scheduling: issues for lawyers* (Constr. Law Int'l 2018); *The Legal Maze of the Keystone XL Pipeline* (Int'l Constr. Law Rev. 2016); *Construction ADR* (ABA 2014) (chapter on international Choice of Law and Venue); and *Construction Damages and Remedies*, 2nd edition (ABA 2013) (chapters on Theories of Recovery, Elements of Damages, and Proof of Damages). Mr. Oles received his undergraduate degree (with distinction) in history from Stanford University (Phi Beta Kappa). He was Executive Editor of the *Washington Law Review* and received his *juris doctor* (with honours) from the University of Washington.

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Established in 1893, Oles Morrison Rinker & Baker LLP is one of the West Coast's most experienced construction law firms with more than 30 attorneys practising at offices located in Alaska, California and Washington. We have been providing legal counsel to public and private clients throughout the nation and internationally in all phases of construction and government contracting since the 1930s. Our attorneys play integral roles in a wide range of leading infrastructure projects, transportation systems and real estate developments. In addition to our primary practice areas of construction and government contracts, our clients look to us for our legal counsel on commercial litigation, business and real estate. Our international work has included a variety of transactional assignments, in addition to a growing volume of dispute resolution assignments between international

companies. Chambers and Partners recognised Oles Morrison Rinker & Baker in its annual *Chambers USA Guide* as a leading Washington firm in the area of construction law.

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1 Making Construction Projects

1.1 What are the standard types of construction contract in your jurisdiction? Do you have: (i) any contracts which place both design and construction obligations upon contractors; (ii) any forms of design-only contract; and/or (iii) any arrangement known as management contracting, with one main managing contractor and with the construction work done by a series of package contractors? (NB For ease of reference throughout the chapter, we refer to “construction contracts” as an abbreviation for construction and engineering contracts.)

The Construction Industry Federation of Zimbabwe (“CIFoZ”) established the National Joint Practice Committee (“NJPC”) Standard Contracts 2000, the main one being the NJPC Building Contract together with two sub-contracts (“the NJPC contracts”). These contracts are largely based on the *Fédération Internationale des Ingénieurs-Conseils* (“FIDIC”) Forms of Contract and have been endorsed by FIDIC. These contracts are essentially managing contracts. The main contract is between an employer and the principal contractor, administered through an administrator who is essentially a consultant. The first sub-contract regulates an arrangement between a main contractor and a sub-contractor, while the second sub-contract regulates the agreement between an employer and any sub-contractor nominee of his choice. The NJPC contracts are largely focused on construction works but make provision for design works in cases where the design function is given to the principal contractor. There are no design-specific standard contracts in Zimbabwe, nor are these common.

In large construction projects, parties are increasingly adopting the FIDIC Forms of Contract. Contracts which place both design and construction obligations upon contractors are not uncommon and reliance is placed in this regard on the FIDIC Yellow Book. Design-only contracts are not common. Most contractors in large construction projects are foreign companies who prefer to use the FIDIC Forms of Contract.

1.2 How prevalent is collaborative contracting (e.g. alliance contracting and partnering) in your jurisdiction? To the extent applicable, what forms of collaborative contracts are commonly used?

Collaborative contracting is quite common in Zimbabwe, depending on the size of the project. The standard contracts used are the NJPC contracts as well as FIDIC Forms of Contract as detailed in question 1.1 above.

1.3 What industry standard forms of construction contract are most commonly used in your jurisdiction?

The NJPC contracts and the FIDIC Forms of Contract are commonly used. Please refer to question 1.1 above.

1.4 What (if any) legal requirements are there to create a legally binding contract (e.g. in common law jurisdictions, offer, acceptance, consideration and intention to create legal relations are usually required)? Are there any mandatory law requirements which need to be reflected in a construction contract (e.g. provision for adjudication or any need for the contract to be evidenced in writing)?

The general concepts of offer and acceptance and the intention to create binding legal relations (*animus contrahendi*) are essential requirements to any valid contract in our jurisdiction. Generally, there is no requirement for contracts to be in written form. Verbal agreements are equally binding where the terms of same are clear or easily ascertainable. However, parties are generally advised to enter into written agreements, as it is easier to prove the terms in the event of disputes arising. The parties’ freedom to agree on the contractual terms is subject to certain statutes such as the Contractual Penalties Act [Chapter 8:04] and Consumer Contracts Act [Chapter 8:03], which impose consumer protectionism and thereby limit the freedom to contract. Although the general law of contract is Roman-Dutch Law, parties are free to prescribe a law applicable to their agreement (*lex loci*) as well as the dispute resolution mechanism. For instance, parties can agree to resolution of disputes through arbitration proceedings to be held at a place of arbitration in another jurisdiction under agreed arbitration rules.

1.5 In your jurisdiction please identify whether there is a concept of what is known as a “letter of intent”, in which an employer can give either a legally binding or non-legally binding indication of willingness either to enter into a contract later or to commit itself to meet certain costs to be incurred by the contractor whether or not a full contract is ever concluded.

The concepts of “Letters of Intent”, “Expressions of Interest” and “Memorandums of Understanding” are common in our jurisdiction. Subject to agreement between the parties, these can be binding or non-binding. Such arrangements can provide mechanisms for exit/termination of rights and obligations subject to certain circumstances. It is not uncommon for parties to provide for payment of costs incurred by the aggrieved party pursuant

to the transaction in the event of the substantive contracts not being concluded for reasons attributable to the other party.

1.6 Are there any statutory or standard types of insurance which it would be commonplace or compulsory to have in place when carrying out construction work? For example, is there employer's liability insurance for contractors in respect of death and personal injury, or is there a requirement for the contractor to have contractors' all-risk insurance?

Yes. The construction industry normally requires all-risk insurance (including third-party liability) due to the high incidence of accidents in the construction sector. It is also common for professional consultants to obtain professional indemnity insurance. In large construction projects which are funded by international institutions, lenders have also started to request procurement of political risk insurance, and completion risk insurance. The contractors are also required to procure insurance cover for the workers involved in construction work under the National Social Security Authority ("NSSA") Accident Prevention and Workers Compensation Scheme (Notice No. 68 of 1990).

1.7 Are there any statutory requirements in relation to construction contracts in terms of: (a) labour (i.e. the legal status of those working on site as employees or as self-employed sub-contractors); (b) tax (payment of income tax of employees); and/or (c) health and safety?

There are some statutory requirements in respect of certain construction contracts. Generally, the law in Zimbabwe requires every company involved in construction to comply with labour, tax, health and safety laws.

Generally, occupational health and safety laws that are applicable to all employers and employees across sectors are the Labour Act [Chapter 28:01] and the NSSA Accident Prevention and Workers Compensation Scheme (Notice No. 68 of 1990). At a secondary level, there are the Protection from Smoking (Public Health (Control of Tobacco) Regulations S.I.264 of 2002 that prohibit smoking in enclosed public places including workplaces, the Labour Relations (HIV and AIDS) Regulations S.I.202 of 1998 which prohibit discrimination on the grounds of AIDS/HIV status, the Pneumoconiosis Act [Chapter 15:08], and the Factories and Works Act [Chapter 14:08] and its regulations.

Construction contractors are allowed to employ expatriate workers with specialised skills, subject to the granting of the relevant work permits and residency permits by the relevant governmental authorities. The Engineering Council Act (Chapter 27:22) provides that no person who is not ordinarily resident in Zimbabwe, nor foreign firms, are allowed to carry out any engineering work without being registered with the Council of Engineers. Every foreign firm that wishes to perform or engage in engineering work in Zimbabwe must first register with the Council and obtain a practising certificate before undertaking any engineering work, and such certificate may only be granted for specific projects that require expertise and specialised skills or technology that are not available in Zimbabwe.

Zimbabwe's tax system is a source-based system. The contractor is obliged to deduct pay-as-you-earn ("PAYE") tax from the salaries of all taxable employees and remit the same to the fiscal authorities.

Section 19A of the Income Tax Act provides for the taxation of non-resident companies that operate through a permanent establishment in Zimbabwe. A permanent establishment is widely defined and would include where a fixed place of business is established in Zimbabwe. A fixed place of business is defined widely, and includes a place of management, a branch, an office, a factory, a workshop, an installation or structure for the exploration of natural resources, a mine, an oil or gas well, a quarry or any other place of extraction of natural resources, a building site, or a construction or installation project.

All qualifying contractors are required to pay corporate taxes to the fiscal authorities. A new business is required to be registered with the Zimbabwe Revenue Authority ("ZIMRA") within 30 days of incorporation. All companies must appoint a public officer of the company within one month of the establishment of such office or place of business. The public officer has to be approved by the Commissioner General and is answerable for all company tax matters.

Where a contractor is not registered for tax purposes, the employer is obliged to deduct withholding tax from any payment made to such contractor pursuant to the contract and remit same to the fiscal authorities.

Under the Workers Compensation Scheme, the employer is liable for any amounts due in respect of the workers' contributions to the scheme until such time as the contractor is assessed by NSSA. The employer is entitled to recover any amounts paid to NSSA pursuant to this.

1.8 Is the employer legally permitted to retain part of the purchase price for the works as a retention to be released either in whole or in part when: (a) the works are substantially complete; and/or (b) any agreed defects liability period is complete?

This normally depends on the provisions of the contract. In practice, provision is normally made for retention money, which is money that is withheld until the taking over of the works or the end of the defects liability period, whichever the parties agree to. The NJPC contracts allow for a retention of monies paid by an employer as security for completion of the works and the making good of defects. The NJPC issues, from time to time, a recommended scale of retention percentages to be used. The amount to be retained by an employer shall be the retention percentage of the value of the work and materials. The exact amount of the retention money, and when the retention money is payable, will depend on the terms of the contract.

It is not uncommon for parties to agree to the release of part of the retention money upon the taking over of the works, with the balance being paid upon expiration of the agreed defects liability period. Typically, payments will be made by the employer to the contractor at intervals based on the production of progress certificates, which must state the amount payable. The contract normally provides that a certain percentage of each of these payments stated in the certificate be withheld as the retention money.

Where retention money is not provided for, performance guarantees from the contractor and sub-contractors are normally required. Sometimes both retention and performance bonds are agreed upon.

1.9 Is it permissible/common for there to be performance bonds (provided by banks and others) to guarantee the contractor's performance? Are there any restrictions on the nature of such bonds? Are there any grounds on which a call on such bonds may be restrained (e.g. by interim injunction); and, if so, how often is such relief generally granted in your jurisdiction? Would such bonds typically provide for payment on demand (without pre-condition) or only upon default of the contractor?

Performance bonds, insurance, bank and parent company guarantees are used extensively in construction projects. The nature of such bonds and guarantees is a matter of contract between employer and contractor. There are no restrictions on the nature of such bonds or guarantees. Performance bonds are mandatory in government and state-owned enterprise construction projects, especially in cases where advance payments are made to the contractor. The courts can grant an interim injunction to restrain calls on such bonds if the contractor proves to the court that the call is not warranted or there are disputes under the construction contract which have been referred to arbitration. The court ruled in one case that paying on the performance bond on demand when there are disputes between the parties would constitute denying the contractor the right to be heard and the courts will be inclined to grant the injunction pending a determination of the main dispute.

1.10 Is it permissible/common for there to be company guarantees provided to guarantee the performance of subsidiary companies? Are there any restrictions on the nature of such guarantees?

Company guarantees are permissible but not common in Zimbabwe. Whether such guarantees would be acceptable is a matter that largely depends on the agreement of the parties having regard to the stature of the holding company issuing the guarantee. Bank and insurance guarantees are generally preferred as they carry low risks of default in the event that there is a call on the guarantee.

1.11 Is it possible and/or usual for contractors to have retention of title rights in relation to goods and supplies used in the works? Is it permissible for contractors to claim that, until they have been paid, they retain title and the right to remove goods and materials supplied from the site?

It is possible for contractors to have retention of title rights in relation to goods and supplies used in the works, depending on the terms of the agreement regulating the relationship. In principle, it is permissible and normal for contractors to have retention of title rights in relation to goods and supplies used in the works, and to remove goods and materials from the site if payment is not forthcoming.

However, it should be noted that our common law of property recognises the principle of accession. If the materials permanently accede to the structure and the land, they become part of the structure and cannot be removed if such removal will cause damage to the structure. It is also not possible to contract out of the common-law principles relating to accession.

Zimbabwean law also recognises a builder's or contractor's lien, which operates by law and is a form of enrichment lien.

The lien (*ius retentionis* or right of retention) entitles the holder thereof, in this case the builder, to retain possession of the property until the expenses incurred by the builder in respect of the property which are recoverable by the builder are paid to the builder. A lien is discharged after the claim is satisfied.

2 Supervising Construction Contracts

2.1 Is it common for construction contracts to be supervised on behalf of the employer by a third party (e.g. an engineer)? Does any such third party have a duty to act impartially between the contractor and the employer? If so, what is the nature of such duty (e.g. is it absolute or qualified)? What (if any) recourse does a party to a construction contract have in the event that the third party breaches such duty?

Yes, it is common for employers to engage project managers to supervise their projects. Generally, all public procurement work is subject to monitoring by the Procurement Board as constituted in terms of the Procurement Act (Chapter 22:07). In private contracts, subject to agreement, third parties usually act as an employer's representative, in which case they will interface with the contractor, supervise compliance with the terms of the construction contract and take remedial action if necessary, and give instructions to the contractor on behalf of the employer. Alternatively, the third party could play a limited advisory role where it will monitor the contractor's performance, report and make recommendations to the employer who will engage the contractor itself. The third-party project manager/supervisor must exercise its duties professionally and, to the extent possible, impartially, in order to ensure compliance with the terms of the contract and applicable laws and by-laws. If the third party acts as the employer's agent, it is up to the employer to terminate the appointment in the event of breach.

It should be noted that there are also regulatory requirements for every construction site to be inspected/supervised by State/local government authorities (as part of the authorisation for construction works). In supervising construction projects, the respective government authorities may suspend construction contracts where there is a breach of law, construction norms or regulations, and only through a petition to the courts or using the courts' administrative means. However, in doing so, they will be acting on behalf of the relevant local government authority or administrative institution. Each local government authority has by-laws that regulate the standards to be observed in carrying out the construction works.

2.2 Are employers free to provide in the contract that they will pay the contractor when they, the employer, have themselves been paid; i.e. can the employer include in the contract what is known as a "pay when paid" clause?

The construction contract, like any commercial contract, records the terms agreed to by the parties who are at liberty to agree on any terms and conditions which are not prohibited by law and which do not offend public policy. In this vein, depending on the circumstances of the case, the parties may agree that the employer will pay the contractor when the employer itself has been paid.

2.3 Are the parties free to agree in advance a fixed sum (known as liquidated damages) which will be paid by the contractor to the employer in the event of particular breaches, e.g. liquidated damages for late completion? If such arrangements are permitted, are there any restrictions on what can be agreed? E.g. does the sum to be paid have to be a genuine pre-estimate of loss, or can the contractor be bound to pay a sum which is wholly unrelated to the amount of financial loss likely to be suffered by the employer? Will the courts in your jurisdiction ever look to revise an agreed rate of liquidated damages; and, if so, in what circumstances?

It is permissible for the parties to agree in advance to the quantum of liquidated damages or penalties payable by the contractor to the employer in the event of particular breaches, e.g. liquidated damages for late completion. This is usually fixed as a percentage of the contract value, and is normally capped at 10%. These liquidated damages or penalties are, however, subject to the provisions of the Contractual Penalties Act [Chapter 8:04] where applicable. The court can reduce the penalty in cases where the penalty is out of proportion to the loss or damage suffered at the invitation of the other party. The party seeking to reduce the agreed damages must present evidence before the court to show that the actual damages or loss suffered by the party concerned are far less than the amount agreed to in the contract. This is a matter entirely in the discretion of the court.

Parties may agree on the contractual penalty being payable in case of a breach of the parties' obligations under the construction contract. Zimbabwean law does not require that the amount determined as a penalty must be a genuine pre-estimate of loss. Invariably, the agreed damages are capped at amounts far less than the actual loss incurred.

Section 88 of the Procurement Act (Chapter 22:07) stipulates the manner in which such liquidated damages shall be provided in public procurement contracts where the parties have agreed to make provisions for liquidated damages.

The main requirement is that the penalty rate must be agreed by both parties in the contract and should be in the frameworks prescribed in the law (min-max). However, if the intent of the party is to compensate the financial loss, the amount must be evidenced by facts.

3 Common Issues on Construction Contracts

3.1 Is the employer entitled to vary the works to be performed under the contract? Is there any limit on that right?

Normally this is to be stipulated or addressed in the contract, which ordinarily prescribes the nature and scope of the allowable variations and the procedure to be adopted where a variation to the agreed works is sought. If the contract does not provide for variations to the works, any variation of the scope of work may be performed only on the basis of an additional agreement signed by both parties in accordance with the contract's non-variation clause. Variations from design documentation require additional approval from State authorities.

3.2 Can work be omitted from the contract? If it is omitted, can the employer carry out the omitted work himself or procure a third party to perform it?

It is normal for parties to agree to omission of certain works for various reasons. Such agreed omissions should preferably

be recorded in the construction contract. The omitted works can be completed by the employer or a third party engaged by the employer.

3.3 Are there terms which will/can be implied into a construction contract (e.g. a fitness for purpose obligation, or duty to act in good faith)?

Where the parties have not specifically addressed this, certain terms are implied into a construction contract by law or practice. For instance, all contracts must comply with applicable laws, and the contractor shall be obliged to follow construction norms, health, safety and environmental rules, and any other law imposed by the State, at all times.

Normally, general principles of contract apply in this regard. Certain terms, which necessarily arise from the contractual relationship between the employer and the contractor, or which are necessary in the business sense to give effect to the contract, will be implied. Implied terms may include that the employer will co-operate with the contractor, or that the employer will not deprive the contractor of possession of the construction site save in accordance with the terms of the agreement.

It may also be an implied term that the contractor will do the work in a good and workmanlike manner, use suitable material and perform his obligations in such a way as to conform to the applicable building regulations. These are just examples of implied terms. These can of course be express terms in the construction agreement.

3.4 If the contractor is delayed by two concurrent events, one the fault of the contractor and one the fault or risk of his employer, is the contractor entitled to: (a) an extension of time; and/or (b) the costs arising from that concurrent delay?

Under the NJPC, in the event of a concurrent delay attributable to both parties, the contractor would normally be entitled to an extension of time that takes into account the delay caused by the contractor. The contractor would normally not be entitled to recover costs in respect of the concurrent delay. In all instances, however, regard must be had to the facts, as there are cases where it is appropriate for the costs to be shared.

3.5 Is there a time limit beyond which the parties to a construction contract may no longer bring claims against each other? How long is that period and when does time start to run?

As a general rule, the limitation period for prescription of a claim (usually debts) for disputes arising from contracts is three years. The prescription period starts to run from the date the cause of action arises, that being the time from which the claimant became aware of all the facts which are necessary to enable it to prove its cause of action. Ordinarily, the limitation period starts upon final acceptance of the works (taking over), even if the contract provides for partial acceptances. However, if the contract provides for a warranty period longer than the prescription period then claims under such warranty can be made at any time during the subsistence of the warranty.

3.6 Which party usually bears the risk of unforeseen ground conditions under construction contracts in your jurisdiction?

Normally, construction is carried out on the basis of design documentation. A geotechnical survey is required to be done before the construction works begin. If such survey is provided by the employer, the contractor acts on the basis of relied-upon information. Contractors are usually permitted to verify the information before a construction contract comes into effect. After it comes into effect, the contractor bears the responsibility for unforeseen ground conditions save where the failure to foresee same was a consequence of the professional negligence of the persons conducting the geotechnical survey. In any event, the obligations in the event of unforeseen ground conditions must be addressed in the construction contract.

3.7 Which party usually bears the risk of a change in law affecting the completion of the works under construction contracts in your jurisdiction?

Since changes in law affecting contractual relations are regarded as *force majeure* circumstances, both parties will bear the risk. However, in big construction projects of national interest which are funded by international institutions, the Project Company usually enters into an Implementation Agreement pursuant to which the government undertakes to provide relief to the Project Company where it is adversely affected by such changes in law.

3.8 Which party usually owns the intellectual property in relation to the design and operation of the property?

It will depend on the provisions of the design agreement. Normally the designer is the owner of the intellectual property and the employer has rights of use.

3.9 Is the contractor ever entitled to suspend works?

Yes, the contractor is entitled to suspend works when the employer fails to fulfil its obligations under the construction agreement, such as payment, failure to provide materials, equipment, or technical documentation as may be applicable.

3.10 Are there any grounds which automatically or usually entitle a party to terminate the contract? Are there any legal requirements as to how the terminating party's grounds for termination must be set out (e.g. in a termination notice)?

The parties are free to regulate the circumstances under which either party is entitled to terminate the contract. The law of Zimbabwe recognises the doctrine of freedom of contract.

A contract is usually terminated through performance, novation, release, delegation, settlement, set-off, merger, prescription, supervening impossibility and on notice given by an aggrieved party in accordance with the relevant contractual provisions if the other party has committed a material breach of the contract.

In addition, the construction contract often provides for the employer's right to terminate the contract if there is a significant delay in the contractor's execution of the works, or for defaults listed in the contract.

It is generally preferable to expressly set out the termination rights, and the consequences of such termination in the contract, although failure to do so does not take away the aggrieved party's termination rights at law.

3.11 Do construction contracts in your jurisdiction commonly provide that the employer can terminate at any time and for any reason? If so, would an employer exercising that right need to pay the contractor's profit on the part of the works that remains unperformed as at termination?

Construction contracts generally provide for the right of the employer to cancel the contract for cause. Cancellation by the employer may be done in the event of insolvency, neglect or failure to complete work timeously resulting in the works being materially affected, or suspension of work without cause on the part of the principal contractor. Cancellation for no cause is uncommon. As termination is done due to cause, no payment is due to the contractor in respect of the work that remains unperformed unless there is a specific provision in the contract for this.

3.12 Is the concept of *force majeure* or frustration known in your jurisdiction? What remedy does this give the affected party? Is it usual/possible to argue successfully that a contract which has become uneconomic is grounds for a claim for *force majeure*?

Yes, the use of *force majeure* clauses in commercial contracts, including construction contracts, is common practice in Zimbabwe. *Force majeure* circumstances provide full release from liabilities under the commercial contract after a specified period. *Force majeure* events may widely be defined as extraordinary, unpreventable and unforeseeable circumstances caused by a natural phenomenon (such as an earthquake, landslide, hurricane, drought and others) or social and economic circumstances (such as war, blockade, import and export bans in the State interest and others) which are not controllable by the will or action of either party and due to which the parties cannot perform their contractual obligations. The mere fact that a contract has become uneconomic is not sufficient grounds for a claim for *force majeure*. The parties are also free to agree on the events or circumstances constituting *force majeure* and how such events or circumstances shall be treated.

3.13 Are parties, who are not parties to the contract, entitled to claim the benefit of any contractual right which is made for their benefit? E.g. is the second or subsequent owner of a building able to claim against the contractor pursuant to the original construction contracts in relation to defects in the building?

Contracts made for the benefit of a third party are binding if accepted by a third party for whose benefit they were made. As a general rule, during transfer of title to the property (building), the new owner acquires rights and obligations related to such property. In the circumstances, subsequent owners of a building may be able to claim against the original contract in relation to defects in the building only if such defects were revealed during the defects liability period provided by the original contract.

3.14 On construction and engineering projects in your jurisdiction, how common is the use of direct agreements or collateral warranties (i.e. agreements between the contractor and parties other than the employer with an interest in the project, e.g. funders, other stakeholders, and forward purchasers)?

These are quite common in large construction projects which are funded by international lenders. This allows the third parties with interest in the project to step in, in the event of issues with the employer.

3.15 Can one party (P1) to a construction contract, who owes money to the other (P2), set off against the sums due to P2 the sums P2 owes to P1? Are there any limits on the rights of set-off?

Set-off is recognised under common law in Zimbabwe. A debt qualifies for set-off if it is admitted or if it is capable of easy and speedy proof. In other words, only liquidated debts may be set off. Furthermore, set-off is only possible if the debts are both due and payable at law. The parties can regulate the question of whether set-off should apply in their contract.

3.16 Do parties to construction contracts owe a duty of care to each other either in contract or under any other legal doctrine? If the duty of care is extra-contractual, can such duty exist concurrently with any contractual obligations and liabilities?

Parties to a construction contract generally owe a duty of care to each other. Should either of the parties commit a delictual act, as opposed to a breach of the contract, such delictual act could give rise to a damages claim. A delict is a breach of a general duty imposed by law which will ground an action for damages in the suit of the person to whom the duty was owed and who has suffered harm in consequence of the breach. A typical delictual claim will arise where a party has suffered damages as a result of the negligence or other unlawful conduct of the other party. The parties are free to limit the circumstances in which such liability may arise.

3.17 Where the terms of a construction contract are ambiguous, are there rules which will settle how that ambiguity is interpreted?

The normal rule is that, when interpreting a contract, the language used in the contract must be given its ordinary, grammatical meaning. If this creates ambiguity, our courts have developed various rules setting out how contracts may be interpreted. The purpose of these rules is to establish the true intention of the parties. The courts are guided, in construing contractual provisions, by judicial precedent. Parties generally regulate what common rules should apply in the interpretation of the contract.

3.18 Are there any terms which, if included in a construction contract, would be unenforceable?

A construction contract, like any commercial contract, records the terms agreed to by the parties, who are at liberty to agree on any terms and conditions which are not prohibited by law and which do not offend public policy. Generally, construction contracts are unenforceable if they are against any applicable laws or are against public policy and morality (*contra bonos mores*).

The parties must therefore exercise care in ensuring that the contract does not make provision for something that is expressly prohibited by law. In large construction contracts, care must be taken to ensure that the employer has secured the relevant exchange control approvals to enable payment to contractors outside Zimbabwe.

3.19 Where the construction contract involves an element of design and/or the contract is one for design only, are the designer's obligations absolute or are there limits on the extent of his liability? In particular, does the designer have to give an absolute guarantee in respect of his work?

The designer bears the risk for his design, but the extent of his liability can be limited contractually. It must be borne in mind, however, that the liability of the designer to a third party cannot be excluded contractually and in the event of the designer being guilty of a delict, such as negligence, and such delict causing damage to a third party, the designer will be liable to that third party.

3.20 Does the concept of decennial liability apply in your jurisdiction? If so, what is the nature of such liability and what is the scope of its application?

Decennial liability does not apply in Zimbabwe. The parties are free, however, to make provision for such liability in their contracts.

4 Dispute Resolution

4.1 How are construction disputes generally resolved?

Disputes can be resolved either by approaching a court or through alternative dispute resolution, such as mediation, arbitration or referral to an expert. Construction agreements typically contain mediation and arbitration clauses in terms whereof parties will submit to arbitration in the event of a dispute. The parties are free to provide the details of the processes applicable to the resolution of any disputes, as long as such processes are not against the law of Zimbabwe. For instance, a clause allowing one party to resort to self-help in the event of a dispute will not be enforceable.

4.2 Do you have adjudication processes in your jurisdiction (whether statutory or otherwise) or any other forms of interim dispute resolution (e.g. a dispute review board)? If so, please describe the general procedures.

Yes, provided the contracts make provision for this. The NJPC Building Contracts make provision for adjudication. The administrator would refer the dispute to adjudication by an adjudicator appointed by the NJPC. The adjudication will be dealt with in terms of the rules of the NJPC. The adjudicator will invite submissions from both parties and has power to review and revise any action or inaction of the administrator relating to the dispute. The adjudicator also has the power to review and revise any decision, opinion, instruction, valuation, certificate or notice and to order such measurement and valuations as he may determine. No reference to adjudication is permitted later than 10 days after the issue of the final payment certificate, save in relation to matters concerning defects and the release of the retention.

4.3 Do the construction contracts in your jurisdiction commonly have arbitration clauses? If so, please explain how, in general terms, arbitration works in your jurisdiction.

Construction contracts in Zimbabwe commonly have arbitration clauses providing for referral of disputes to one or more arbitrators appointed either by agreement between the parties or, failing that, by some other body such as the Commercial Arbitration Centre of Zimbabwe or a relevant professional body such as the Engineering Council of Zimbabwe, the Valuers Council of Zimbabwe, etc. The parties are free to provide in the construction contract how the arbitration process is to be regulated in relation to the number of arbitrators to be involved, the seat of the arbitration, rules of procedure, the language to be used, and the period during which the arbitrator is required to render his decision, failing which the procedure to be followed in arbitration proceedings is as stipulated in the Arbitration Act [Chapter 7:15].

4.4 Where the contract provides for international arbitration, do your jurisdiction's courts recognise and enforce international arbitration awards? Please advise of any obstacles (legal or practical) to enforcement.

Yes. Zimbabwe ratified the Washington Convention on the Settlement of Investment Disputes between States and Nationals of Other States which was incorporated into Zimbabwean law by the Arbitration (International Investment Disputes) Act [Chapter 7:03].

The Convention on the Recognition and Enforcement of Foreign Arbitral Awards requires courts of contracting states to give effect to private agreements to arbitrate and to recognise and enforce arbitration awards made in the contracting countries. In terms of Article 3 of the Convention, each contracting state shall recognise arbitral awards as binding and enforce them in accordance with the rules of procedure of the territory where the award is relied upon.

Under the Convention, an arbitration award issued in any contracting state can generally be freely enforced in any other contracting state (save that some contracting states may elect to only enforce awards from other contracting states – the “reciprocity” reservation).

Additionally, Zimbabwe adopted (with amendments) the Model Law on International Commercial Arbitration adopted by the United Nations Commission on International Trade Law on 21 June 1985, to give effect to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards adopted in New York on 10 June 1958. Awards from international arbitration proceedings are recognised and enforced in Zimbabwe subject to compliance with the procedures in the Model Law.

Apart from the above, the Civil Matters (Mutual Assistance) Act [Chapter 8:02] allows for the registration of awards from an international tribunal as may be declared from time to time.

4.5 Where a contract provides for court proceedings in your jurisdiction, please outline the process adopted, any rights of appeal and a general assessment of how long proceedings are likely to take to reduce: (a) a decision by the court of first jurisdiction; and (b) a decision by the final court of appeal.

Where there are no factual disputes, a party can approach the court by way of a Court Application instituted by way of notice of motion accompanied by supporting affidavits. If, however, there is a factual dispute, the correct procedure to follow is to approach the court by way of action, which is instituted by summons. Ordinary actions or applications are usually resolved by the court of first instance within six to 14 months. Depending on the urgency of the matter, a party can bring an application to court on an urgent basis, in which case the rules of court relating to time periods are relaxed. This procedure is usually resorted to in cases in which one party desires, for instance, to obtain an interdict or an injunction against the other party.

Appeals against decisions of the High Court may be directed to the Supreme Court and it normally takes six to 12 months for an appeal to be heard and determined. Where the issue raises a constitutional question, it may be directed to the Constitutional Court.

All decisions and proceedings of any inferior court and of any tribunal, board or officer performing judicial, quasi-judicial or administrative functions may be taken on review in the High Court, in respect of grave procedural irregularities or illegalities occurring during the course of such proceedings.

4.6 Where the contract provides for court proceedings in a foreign country, will the judgment of that foreign court be upheld and enforced in your jurisdiction? If the answer depends on the foreign country in question, are there any foreign countries in respect of which enforcement is more straightforward (whether as a result of international treaties or otherwise)?

Section 3 of the Civil Matters (Mutual Assistance) Act [Chapter 8:02] allows judgments given in “designated countries” to be registered by the High Court of Zimbabwe and enforced as if they were judgments of the High Court of Zimbabwe. The designated countries will be deemed so in terms of a statutory instrument issued by the responsible Minister. The process is therefore straightforward in respect of these designated countries. Decisions from countries outside of the Designated Countries List can still be enforced. The decision of the foreign court would be taken as the cause of action on the basis of which fresh proceedings are commenced in Zimbabwe.



Nikita Madya joined the firm on 1 July 2000 and became a Partner on 1 July 2003. He heads the firm's Energy, Infrastructure and Natural Resources Department and is co-head of the Commercial and Corporate Department. He has a large commercial practice and advises several listed and unlisted companies in relation to acquisitions, mergers, disposals and various types of contracts. He is currently involved in greenfield projects in the energy sector, with work covering all aspects, including the construction elements involved in such projects. He has handled several completed transactions for companies listed on the Zimbabwe Stock Exchange, including share option schemes, rights issues, mandatory offers to minorities, Zimbabwe Stock Exchange Rules compliance and related matters. He has acted and continues to act as local counsel for a number of international law firms handling investment transactions into Zimbabwe. He is also involved in advising local, regional and international financial institutions in various loan transactions.

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