Risk allocation in the FIDIC Conditions of Contract (1999) for Construction (Red Book) and the FIDIC Conditions of Contract (1999) for EPC/Turnkey Projects (Silver Book) from the perspective of a German lawyer?

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In 1999 FIDIC updated its existing standard forms of Conditions of Contract, i.e. the Conditions of Contract for Works of Civil Engineering Construction (the so-called "Red Book") and the Conditions of Contract for Electrical and Mechanical Works including Erection ("Yellow Book"), as well as the Conditions of Contract for Design-Build and Turnkey ("Orange Book").

The new FIDIC forms edition (1999) are composed by the Conditions of Contract for Construction that replace the former Red Book and the Conditions of Contract for Plant and Design-Build that replace the former Yellow and Orange Books.

The main motive for publishing new editions of the FIDIC books is to adjust them to significant changes that the construction industry has undergone since the last edition. Additionally, FIDIC has to take into account that multinational development banks (Worldbank, EBRD etc.), have included the FIDIC standard forms into their bidding documents. Discussions between the MDB´s and FIDIC will finally lead to a hopefully harmonized version of the Red Book which is expected to be published in 2005.

FIDIC standard forms are generally known as being well balanced because both parties bear parts of the risks arising from the project. However, in the eyes of English contractors and lawyers there is nothing too bad in assuming risk (Pickavance, Delay and Disruption in Construction Contracts, 2.28). There are challenged by the tasks to identify the risk retained and to recognize the fact that there is a risk (Pickavance, Delay and Disruption in Construction Contracts, 2.28). On the contrary for German contractors risk allocation is an entirely technical problem and not a legal issue because they are not really familiar with using several standard forms providing different risk allocation models. They always rely upon the default rule that the apportioning of risks in standard terms is the one provided for by statutory provisions and within the limits of these provisions.

These limits are stated in § 307 German Civil Code (BGB). This statue provides that standard terms of contract are invalid if they put that party to the contract, which has not drafted these terms, in a position which is unreasonably disadvantageous and this is a result of bad faith of the drafter. If there is doubt, an unreasonable disadvantage is assumed if a standard contract term cannot be reconciled with essential basic principles of the statutory rule from which the contract term deviates. Or: if it restricts essential rights or duties resulting from the nature of the contract in such a way that it endangers the purpose of the contract to an extent that this purpose will not be achieved. Only within these statutory limits the parties of a construction contract are free to assume risks in standard business terms. § 307 BGB has lead to many litigated cases that anybody who drafts standard business terms for the construction industry should be aware of.

Thus, in practice Germans contractors almost always accept the risk allocation modal of the so-called "Verdingungsordnung für Bauleistungen" (contract rules for governmental projects), part B, as General Conditions for construction contracts which have to be used for all projects of the German state and the municipalities and which are viewed at as being fair and just for private parties as well. Just recently the German legislator has enacted a privilege that partially makes Part B of the contracting rules for

governmental contracts immune against judicial review. Thus, the main German law books on construction law do not even treat risk allocation as a topic because it does not seem worth to talk about. This does not mean that Germans are not aware of the risks inherent to a construction contract. But it does not spring to their mind that risk allocation modals distinct from the default rules are imaginable and sometimes even necessary.

There is no doubt that German contractors have to change their minds when they start to compete on the international market. They have to understand that German law and German standard forms are not necessarily the only possible approach in respect to risk allocation. They have to take into consideration different risk allocation philosophies by learning the internationally recognized principles of risk apportionment, such as

(1) risks should be allocated to the party that is in the position to control them and

(2) risks should not be allocated to a party that is unable to bear the consequences of a potential risk becoming reality.

On the other hand: Anglo - American contactors should be aware of some more or less substantial particularities of some civil code systems. In German law specific performance is not a discretionary extraordinary remedy but the general rule. Thus, if a defects occurs the employer can demand supplementary performance under § 635 Germany Civil Code (BGB hereinafter). If the employer claims supplementary performance, the contractor may, at his option either remove the defect or produce an entirely new product (§ 635 BGB). Additionally, the principle of good faith is generally recognized, meaning that the contractor cannot just follow the orders of the employer without regarding possible consequences. Contrary to English Law liability for breach of contract means that the party in breach is liable for all losses (including consequential losses) which follow from the breach, provided that there is adequate causation between the breach and the loss. The concept of liquidated damages, well known in common law jurisdictions, is unknown in civil law countries. In these countries penalty-clauses are common and valid as well. Finally, under the Civil Codes the contractors retain all risks until not only substantial completion of the project but until formal “acceptance (Abnahme).” Insofar acceptance should not be confused with the type of acceptance that is required to form a binding contract. This is a completely different issue. Acceptance (Abnahme) in respect to construction contracts under the civil code determines the point in time at which the employer confirms that the works conform to the contract. The contract price becomes due after this point and the burden to prove defects shifts to the employer as does the risk of loss. If the employer has a claim for the correction of a defect, he may, even after he has accepted the works, refuse to pay a reasonable amount of the contract price, namely: three times the estimated costs to correct the defect.

FIDIC forms are generally recognised as a fair and balanced standard form for construction works. The best example for an internationally recognised fair and balanced standard form is the new Red Book which is drafted for the use in traditional projects of civil engineering, such as the construction of infrastructure facilities (roads, bridges, dams etc.). The new Silver Book on the contrary is tailored to somehow different types of projects. These “new” types of projects are based on some trends in the international construction industry: during the recent years there is a certain tendency towards larger and more complex projects at considerably higher costs. Along with this tendency the need for private financing for these undertakings has increased. Likewise, there is a trend preferring direct – face to face contracting at an arms length between employers and contractors without of an engineer who is traditionally in charge of administrating and adjudicating the contract. This kinds of projects typically involve private lenders whose interest not only focus on the financing of the project during the actual construction period, but also extent to some type of

secured cash flow subsequent to the actual works going on. They take into account that the construction contract usually forms just one part of a complex commercial venture, including other concession and financing agreements.

Consequently, lenders and concessionaires as well as the employer want contract terms that ensure an increased certainty that the agreed contract price will be paid and that time for completion will not be exceeded. Thus, the characteristics of such an agreement are that the contractor – without an engineer – assumes full responsibility for the design and construction of the facility, whereas the employer is not involved in the actual construction as far as possible, but receives the certainty of a fixed final price on a lump sum basis, although on a higher price level, and the certainty of a fixed completion date.

The FIDIC Silver Book has adopted most of the wishes of employers and lenders for the above mentioned types of projects. Most of the risks are borne by the contractor including for example (but not limited to them) the risks of unforeseen ground conditions and the responsibility in respect to design which is completely done by the contractor.

German contractors and lawyers are not really familiar with this type of contract terms. For them they seem to be unevenly balanced or even illegal under § 307 (BGB). However, argument is probably without merit in any real worlds case because as a matter of fact German law seldom applies to international construction contracts and even if does it is still an unsettled issue whether conformity to German law offers legal protection against risks already assumed, Besides, there is no express exemption from the contra proferentem rule in respect to standard terms of contract having been drafted by representative bodies or committees after lobbying efforts of one of the parties; as it is under English law (see in so far Adriaanse, Construction Contract Law, 14).

In the long run even German contractors will have to accept that the Silver Book is highly transparent and that the application of the Silver Book is recommended only if the employer is willing to pay a higher price than for a contract based on the FIDIC Red Book. The issues are how to ensure that employers will not misuse the Silver Book and to identify the risks which are inherent to this contract form and to be aware of the simple fact that to transfer a risk does not reduce it at all. Finally, the issue which party bears a risk is simply a matter of commercial negotiation.

This leads to the conclusion that employers have to adjust their bidding procedures if they are willing to use the Silver Book. Art. 28 of the directive 2004/18/EC on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts provides that: “In awarding their public contracts, contracting authorities shall apply the national procedures adjusted for the purposes of the directive. In most cases the bidder who has offered the lowest price will be awarded with the contract”. The Standard Bidding Documents for Works of the World Bank provide that the employer will award the contract to the bidder whose bid has been determined to be substantially responsive to the bidding documents and who has offered the lowest evaluated bid price. This is not acceptable for contracts based on the Silver Book because price competition is not the appropriate approach for such contracts.

Once the appropriate procurement method has been chosen it is up to the bidders to identify the contractual risks and to evaluate the apportionment of risks to be borne by the employer and the contractor. There is no doubt that risks vary in construction contracts depending upon many factors that can effect the progress and the completion of the work, such as (see Adriaanse, Construction Contract Law, 4):

Unforeseen events and circumstances (weather, ground conditions, shortage of material, shortage of

labour, accidents, during the construction period it turns out that particular innovative design is impossible to construct etc.), currency risks, interface problems, war, strike etc.

When evaluating risks under the FIDIC Conditions of Contract for Construction and the FIDIC Conditions for EPC / Turnkey Projects, the parties first have to take a look at the scope of either of these forms, since the risks of the employer and the contractor are usually allocated in relation to the true nature of the contract between them. In so far it is evident that the Silver Book imposes most of the risks, especially in respect to price and time for completion on the contractor.

A very important issue are the clauses regulating site data and unforeseeable circumstances. Subclauses 4.10 Silver Book and Red Book provide that the employer shall make available to the contractor all relevant site data and the contractor shall be responsible for interpreting this data. The provision in Silver Book however goes much further by stating that that the contractor is not only in charge of the interpretation but also of the verification of this data. Clause 5.1 of the Silver Book states that the Designer shall be deemed to have scrutinised the employer's requirements, shall be responsible for the design of the works and the accuracy of such requirements and shall not be relieved from his responsibility by data or information received from the Employer. The latter is not responsible for any error, inaccuracy or omission of any kind in his requirements as included in the contract, except for some specific data mentioned in this clause. The problem of a contractor at the time of submission of the tender might be to evaluate the likelihood of encountering such difficulties. In addition to these regulations, sub-clause 4.12 deals with unforeseeable conditions. Under the Red Book unforeseeability is expressly defined in sub-clause 1.1.6.8. If an unforeseeable event occurs the contractor shall be entitled to extension of time and extra payment of costs. The corresponding provision in the Silver Book does not protect bidders in a likewise manner. The Silver Book makes very clear in sub-paragraph (b) that the Contractor accepts total responsibility for having foreseen all difficulties and costs and in sub-paragraph (c) that the contract price shall not be adjusted to take account of any of these unforeseeable events or circumstances.

On the other hand the burden of risk may vary according to the applicable law. Whereas for example in some jurisdictions the modification of the contract in the event of unforeseen circumstances has been established by law or case law other jurisdictions are particularly strict. In some countries (e.g. England, Italy, Netherlands) it has been admitted (with different nuances) that a contract, the obligations of which can still be performed, must be modified in so far as performance becomes ruinous (see Rodière/Tallon, Les modifications du contrat au cours de son execution en raison de circonstances nouvelles, 186). In France and in Belgium to the contrary it seems that the parties will be bound to the contract even if the contract is unbalanced (see Rodière/Tallon, Les modifications du contrat au cours de son execution en raison de circonstances nouvelles, 186). In Germany according to § 313 BGB adaptation of the contract may be claimed if circumstances upon which a contract was based have materially changed after conclusion of the contract and if the parties would not have concluded the contract or would have done so upon different terms if they had foreseen that change, in so far as, having regard to all the circumstances of the specific case, in particular the contractual or statutory allocation of risk, it cannot reasonably be expected that a party should continue to be bound by the contract in its unaltered form.

The contractor who has realized that all these risks are imposed upon him must prepare his bid by evaluating especially the following risks:

- Design must be fit for the purpose
- All eventually but actually unforeseeable events (knowing that it is not logical that an event can be eventually unforeseeable, because if it is then it is no longer unforeseeable)

- Errors concerning site data
- Errors concerning accuracy of employer's requirements