
CHAMBERS GLOBAL PRACTICE GUIDES

Construction Law 2024

Definitive global law guides offering
comparative analysis from top-ranked lawyers

Contributing Editor

Peter Habraken
HabrakenRutten



Chambers

Global Practice Guides

Construction

Contributing Editor

Peter Habraken

HabrakenRutten

2024

Chambers Global Practice Guides

For more than 20 years, Chambers Global Guides have ranked lawyers and law firms across the world. Chambers now offer clients a new series of Global Practice Guides, which contain practical guidance on doing legal business in key jurisdictions. We use our knowledge of the world's best lawyers to select leading law firms in each jurisdiction to write the 'Law & Practice' sections. In addition, the 'Trends & Developments' sections analyse trends and developments in local legal markets.

Disclaimer: The information in this guide is provided for general reference only, not as specific legal advice. Views expressed by the authors are not necessarily the views of the law firms in which they practise. For specific legal advice, a lawyer should be consulted.

GPG Director Katie Burrington

Content Management Director Claire Oxborrow

Content Manager Jonathan Mendelowitz

Senior Content Reviewer Sally McGonigal, Ethne Withers

Content Reviewers Vivienne Button, Lawrence Garrett, Sean Marshall, Marianne Page, Heather Palomino, Deborah Sinclair, Stephen Dinkeldein and Adrian Ciechacki

Content Coordination Manager Nancy Laidler

Senior Content Coordinator Carla Cagnina

Content Coordinator Hannah McDowell

Head of Production Jasper John

Production Coordinator Genevieve Sibayan

Published by

Chambers and Partners

165 Fleet Street

London

EC4A 2AE

Tel +44 20 7606 8844

Fax +44 20 7831 5662

Web www.chambers.com

Copyright © 2024

Chambers and Partners

CONTENTS

INTRODUCTION

Contributed by Peter Habraken, HabrakenRutten p.5

AUSTRIA

Law and Practice p.9

Contributed by Schoenherr

Trends and Developments p.25

Contributed by Schoenherr

BANGLADESH

Law and Practice p.32

Contributed by Dr Kamal Hossain and Associates

BRAZIL

Law and Practice p.51

Contributed by Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados

Trends and Developments p.77

Contributed by Toledo Marchetti Advogados

BULGARIA

Law and Practice p.84

Contributed by Penkova & Partners Law Firm

Trends and Developments p.107

Contributed by Penkova & Partners Law Firm

CANADA

Law and Practice p.114

Contributed by Singleton Urquhart Reynolds Vogel LLP

Trends and Developments p.136

Contributed by Borden Ladner Gervais LLP

CHILE

Trends and Developments p.145

Contributed by Clyde & Co

CHINA

Law and Practice p.153

Contributed by Merits & Tree Law Offices

Trends and Developments p.177

Contributed by Merits & Tree Law Offices

COLOMBIA

Law and Practice p.185

Contributed by Pinilla, González & Prieto

Trends and Developments p.203

Contributed by Pinilla, González & Prieto

DENMARK

Law and Practice p.208

Contributed by Bruun & Hjejle

Trends and Developments p.231

Contributed by Bruun & Hjejle

FINLAND

Law and Practice p.239

Contributed by Lieke Attorneys Ltd

Trends and Developments p.259

Contributed by Lieke Attorneys Ltd

GREECE

Trends and Developments p.265

Contributed by POTAMITISVEKRIS

HONG KONG SAR, CHINA

Law and Practice p.274

Contributed by DLA Piper Hong Kong

INDIA

Law and Practice p.296

Contributed by AZB & Partners

ITALY

Law and Practice p.317

Contributed by Dardani Studio Legale

JAPAN

Law and Practice p.334

Contributed by Mori Hamada & Matsumoto

KUWAIT

Law and Practice p.356

Contributed by GLA & Company

CONTENTS

MALAYSIA

Law and Practice p.379

Contributed by Christopher & Lee Ong

Trends and Developments p.401

Contributed by Christopher & Lee Ong

NETHERLANDS

Law and Practice p.410

Contributed by HabrakenRutten

Trends and Developments p.422

Contributed by HabrakenRutten

NEW ZEALAND

Law and Practice p.426

Contributed by Anderson Lloyd

NORWAY

Law and Practice p.451

Contributed by Advokatfirmaet Thommessen AS

OMAN

Law and Practice p.475

Contributed by Kennedys

QATAR

Law and Practice p.489

Contributed by Al Marri & El Hage Law Office

Trends and Developments p.516

Contributed by Al Marri & El Hage Law Office

SAUDI ARABIA

Law and Practice p.524

Contributed by GLA & Company

SLOVENIA

Law and Practice p.548

Contributed by Andrić & Partners

Trends and Developments p.560

Contributed by Andrić & Partners

SOUTH KOREA

Law and Practice p.563

Contributed by Bae, Kim & Lee LLC

SWEDEN

Law and Practice p.585

Contributed by Advokatfirman Vinge KB

SWITZERLAND

Law and Practice p.605

Contributed by Walder Wyss Ltd

UAE

Law and Practice p.621

Contributed by Herbert Smith Freehills

UK

Trends and Developments p.642

Contributed by Pinsent Masons

USA – NEVADA

Law and Practice p.648

Contributed by Mead Law Group

INTRODUCTION

Contributed by: Peter Habraken, HabrakenRutten

HabrakenRutten is an industry sector boutique law firm focusing on all legal aspects of built and natural assets. The firm's expertise not only encompasses traditional buildings and infrastructure but also all linear and portable assets such as trains, ships, offshore rigs, networks and related technology. Widely recognised as a market leader, HabrakenRutten has been part of nearly every significant project in the Netherlands in the past ten years. The firm has unparalleled knowledge of best market practice and the distribution of risk in this sector. Habraken-

Rutten has six partners and 16 lawyers, all specialists in aspects surrounding infrastructure, real estate, energy and IT/tech, who represent clients not only with advice, drafting and negotiation but also in litigation and arbitration. The firm's recent track record includes renegotiating and litigating a D&C contract for Amare, in The Hague, and advising one of the largest Dutch tank terminal operators on the construction of a new mega tank terminal in the port of Rotterdam.

Contributing Editor



Peter Habraken is a partner at HabrakenRutten and a well-known legal adviser in large projects in the infrastructure, energy/industry, real estate and transport/logistics sectors. His

long-standing focus on asset development and involvement in nearly every significant PPP project in the Netherlands ensures that his

clients have access to best market practice, as well as practical solutions to unique situations. Appreciated for his commercial approach, clients rely on him to achieve "bankable" legal structures and desired exit strategies, as well as risk management throughout the entire life cycle of a project. Peter is a co-founder and member of the Dutch and German Lawyers Association.

HabrakenRutten

Weena 690
3012 CN Rotterdam
Netherlands

Tel: +31 88 374 4900
Fax: +31 10 412 7941
Email: s.rutten@habrakenrutten.com
Web: www.habrakenrutten.com

HABRAKENrutten

INTRODUCTION

Contributed by: Peter Habraken, HabrakenRutten

Overview

The world still seems to be struggling to reach new equilibriums. The international situation remains tense, with existing and looming conflicts, causing uncertainty and pessimism. On a national level, the political status in several large jurisdictions is characterised by sharp divisions, leading to unpredictable policies and outlooks. As a result, all-important financial drivers, such as interest rates and construction costs, continue to affect the construction industry.

The construction sector, however, can be counted on for its optimistic and “can-do” mentality, which is testified by jurisdictions around the world reporting abundant opportunities for the industry, especially in energy projects, infrastructure overhaul and city development. In addition, in Europe, the geopolitical situation seems to be driving a growing tendency for co-operation across national borders – especially where the durable, stable generation and distribution of energy is concerned, but also in the transport infrastructure sector. This too seems to offer new opportunities in an increasingly integrated market for construction projects.

The current common denominators for innovation in the construction sector worldwide seem to be the spread of AI and digitalisation. These developments also call for vigilance in terms of cybersecurity and privacy.

Challenging Circumstances

The circumstances for the construction industry are more challenging than ever. Work seems to be abundant, if only because the generation, transport and distribution of energy needs a fundamental turn-around. The world urgently needs to turn away from fossil fuels to wind, solar and nuclear sources. This also requires new and

larger grids, as well as innovative distribution channels.

In the Netherlands, for instance, there is a massive push away from natural gas as the favourite energy source for heating towards wind- and solar-generated electricity, possibly in combination with hydrogen. The construction sector is struggling to keep pace with demand. In Germany, on the other hand, natural gas is being introduced on a large scale to replace traditional heating oil as an energy source. Energy projects are mentioned in almost every jurisdiction, from Denmark to Canada and from China to Colombia.

These “turn-arounds” involve huge investments, and these in turn require predictable long-term policies. In a number of important jurisdictions, however, politics are sharply divided, resulting in uncertain and sometimes contradictory regulations.

The growing demand for affordable housing is another trend in a number of important jurisdictions. This in itself is a source of work and offers many opportunities. However, challenges exist here as well. Several jurisdictions report mounting political pressure to regulate housing markets. In Austria, for example, stricter regulations on bank financing have led to a sharp decrease in demand for construction projects. In Brazil, the prevailing political uncertainty remains a significant concern for projects. In the Netherlands a new zoning and planning act and an “affordable housing act” have tended to dampen investment appetite. Several jurisdictions also report changes in taxation, curbing returns on investment for real estate projects.

Climate Transition

It is clear that across almost all jurisdictions the so-called climate and energy transition prom-

INTRODUCTION

Contributed by: Peter Habraken, HabrakenRutten

ises to be a strong driver for the construction industry. Ambitions are high: China alone strives to peak carbon dioxide emissions before 2030 and has vowed to achieve carbon neutrality before 2060. Japan has set a goal of achieving a 36% or 38% share of renewable energy in power source composition in 2030. The same picture emerges in other jurisdictions – eg, Brazil, Canada, Denmark, Finland, Japan, the Netherlands and the UAE, to name a few. In Brazil, for instance, a National Basic Sanitation Law will facilitate a EUR34.5 billion overhaul of the sanitation system. In Denmark, a “Construction Think Tank for Sustainability” has been established to implement the green transition of the Danish construction sector itself. Also worth mentioning are the EU “Green Deal” and the US Inflation Reduction Act.

All these ambitions combined have led to frantic activity in fields such as:

- solar and wind energy;
- renewed interest in nuclear energy;
- energy storage;
- green building techniques; and
- construction materials.

Greater dependence on electricity necessitates the renewal and extension of power grids across the globe. Everywhere, the construction industry is gearing up and transforming itself to help achieve these Herculean tasks. Qatar, for example, plans to initiate projects worth EUR19 billion for water and electricity projects alone.

Technological Innovation

The third trend that surfaces across almost all jurisdictions is technological innovation, and this is visible in myriad directions:

- BIM;
- big data;
- use of drones;
- IoT;
- IA; and
- modular construction.

Increasingly, construction companies are reinventing themselves as IT companies. In the Netherlands, for example, companies specialising in infrastructure have developed new business models based on mining data to reduce emissions and save energy, by connecting data from NOX and CO2 sensors via intelligent algorithms to traffic signs, thereby rerouting traffic in big cities. Innovation also takes the form of digitalisation of permitting processes – eg, in Bulgaria and Finland.

That said, it is important not to lose sight of cybersecurity issues that accompany digitalisation. In this regard, the two EU Directives “NIS2” and “CER” are worth mentioning. These Directives will have significant implications for construction – for instance, in large infrastructure projects.

Apart from IT, prefabrication and/or off-site modular construction is increasingly used, both in housing and in industrial projects; in the USA, this has also led to the introduction of a new-form modular construction contract, addressing the legal implications of this building method for traditional EPC contracts.

The use of blockchain and “smart contracts” in the construction industry, however, remains far from common practice and is still virtually unheard of.

INTRODUCTION

Contributed by: Peter Habraken, HabrakenRutten

Legal Trends and Developments

From a legal point of view, a number of legal developments are worth noting, both legislative and in (standard) contracting.

In Austria, the so-called KIM ordinance imposes stricter regulations on bank financing. As said, this has led to a sharp decrease in demand. In Brazil, the “New Infrastructure Debentures” law will stimulate investment by more favourable conditions for (inter alia) non-recourse financing. In Bulgaria, a Bill on Renewable Energy in Marine Spaces will facilitate the construction of offshore wind farms.

In Canada, the federations and a number of states have amended their legislation to secure “prompt payment provisions”; furthermore, recent changes in tendering and surety laws are reported. In Denmark, the so-called “LEG3” clauses are under scrutiny by the courts, which will hopefully lead to a clearer interpretation thereof.

China has launched reforms for the digital management of the entire life cycles of construction projects. In Finland, the new “Building Act” will come into force in 2025, introducing a simplified permitting structure and a main responsibility of the implementer for the total of a new building.

In the USA, new model contracts have been introduced to regulate modular construction projects, making use of the ConcensusDocs forms.

As for global legal trends and developments, the construction industry continues to show a growing degree of alignment, both in legislative initiatives and in the use of standard conditions. The implementation and use of internationally accepted standard contract forms continues to

gather momentum. A number of countries have recently updated their commonly used standard conditions, including Denmark, the Netherlands, Peru, Singapore and Switzerland.

Furthermore, the use of FIDIC (International Federation of Consulting Engineers) and NEC (New Engineering Contract) suites is becoming more widespread, not only in the English-speaking world but also in South America and Africa. At the same time, the introduction of new contract models is being seen, such as “collaborative contracting” in Singapore. These models seek to align the interests of all project participants in order to achieve project objectives, through a co-operative management approach, profit and risk sharing, and the development of mutual trust and confidence between stakeholders.

Conclusion and Outlook

Global developments have led to rising interest rates, rising construction costs, lower yields and being more averse to risk. These dampen investment in construction projects.

Simultaneously, the need to confront the effects of climate change and the altered energy landscape, as well as urbanisation and the demand for (affordable and durable) housing, remain powerful drivers for the construction industry, further fuelled by technological innovations. In addition, shortage of skilled workers tends to create some scarcity, which may strengthen the bargaining power of construction companies. This effect is especially visible in developed markets such as Western Europe.

It is safe to assume that the construction industry will have to adapt itself, becoming more durable – both in its products and in its processes – and embracing innovations.

AUSTRIA

Law and Practice

Contributed by:

Constantin Benes, Peter Madl and Franziska Oczlon
Schoenherr



Contents

1. General p.13

- 1.1 Governing Law p.13
- 1.2 Standard Contracts p.13

2. Parties p.13

- 2.1 The Employer p.13
- 2.2 The Contractor p.13
- 2.3 The Subcontractors p.14
- 2.4 The Financiers p.14
- 2.5 The Designer p.14

3. Works p.15

- 3.1 Scope p.15
- 3.2 Variations p.15
- 3.3 Design p.15
- 3.4 Construction p.15
- 3.5 Site p.16
- 3.6 Permits p.16
- 3.7 Maintenance p.16
- 3.8 Other Functions p.16
- 3.9 Tests p.16
- 3.10 Completion, Takeover and Delivery p.17
- 3.11 Defects and Defects Liability Period p.17

4. Price p.17

- 4.1 Contract Price p.17
- 4.2 Indexation p.18
- 4.3 Payment p.18
- 4.4 Invoicing p.18

5. Time p.18

- 5.1 Planning and Programme p.18
- 5.2 Delays p.19
- 5.3 Remedies in the Event of Delays p.19
- 5.4 Extension of Time p.19
- 5.5 Force Majeure p.19
- 5.6 Unforeseen Circumstances p.20
- 5.7 Disruption p.20

6. Liability p.20

- 6.1 Exclusion of Liability p.20
- 6.2 Wilful Misconduct and Gross Negligence p.20
- 6.3 Limitation of Liability p.20

7. Risk, Insurance and Securities p.21

- 7.1 Indemnities p.21
- 7.2 Guarantees p.21
- 7.3 Insurance p.21
- 7.4 Insolvency p.21
- 7.5 Risk Sharing p.22

8. Contract Administration and Claims p.22

- 8.1 Personnel p.22
- 8.2 Subcontracting p.22
- 8.3 Intellectual Property p.23

9. Remedies and Damages p.23

- 9.1 Remedies p.23
- 9.2 Restricting Remedies p.23
- 9.3 Sole Remedy Clauses p.23
- 9.4 Excluded Damages p.23
- 9.5 Retention and Suspension Rights p.23
- 9.6 Termination p.24

10. Dispute Resolution p.24

- 10.1 Regular Dispute Resolution p.24
- 10.2 Alternative Dispute Resolution p.24

Schoenherr has a solid footprint across Central and Eastern Europe with a strong local presence in 14 countries and a global reputation for its high-end capability across CEE/SEE. The firm's real estate and construction practice continues to enjoy solid growth in Austria and CEE/SEE. Schoenherr's construction team is headed by Constantin Benes and supported by Peter Madl, who has decades of experience and Franziska Oczlon, who is also a qualified architect. The team advises not only high-profile clients on large-scale projects within the energy,

environment, infrastructure and waste management sectors, but also pre-eminent real estate developers on the planning, development and construction of residential, office and retail spaces. The team also focuses on advising clients on post-construction litigation as well as litigation in connection with general construction matters. The team's extensive expertise is complemented by know-how provided by lawyers' cross-practice, especially the firm's real estate and regulatory experts.

Authors



Constantin Benes is a partner with Schoenherr in Vienna and heads Schoenherr's construction team. He specialises in construction law with a particular focus on

industrial facilities as well as the development of housing and office projects, including construction litigation. A further focus of his expertise includes lease contracts, as well as securitisation in connection with reorganisations of financing. Constantin is the author of numerous publications focusing on all areas of real estate and commercial civil law and recently co-authored a section of a practice commentary on tenancy law. He studied in Graz, Austria and at Columbia Law School, New York.



Peter Madl plays a central role in Schoenherr's property-related mandates in Austria and CEE. With an outstanding track record of high-end transactions, he is well equipped to advise Austrian

and international investors on their property dealings in the region. His activities have a strong focus on real estate development and advice with respect to all types of construction contracts for infrastructure projects, shopping centres, condominiums and production sites. He is also very experienced in construction litigation. Peter is a graduate of the University of Vienna (Dr. iur.) and the Vienna University of Economics (Mag. rer. soc. oec.) and he lectures on real estate law at the University of Vienna.

Contributed by: Constantin Benes, Peter Madl and Franziska Oczlon, **Schoenherr**



Franziska Oczlon is both an attorney and a diploma engineer. She thus fits Schoenherr's construction practice, where she focuses on development and infrastructure projects, perfectly.

She graduated from the University of Vienna (Mag. iur.) and Vienna University of Technology (Dipl. Ing.). Before joining Schoenherr, she worked as an architecture graduate at an architectural office.

Schoenherr

A-1010 Vienna
Schottenring 19
Austria

Tel: + 43 1 534 37 50231
Fax: +43 1 534 37 66231
Email: c.benes@schoenherr.eu
Web: www.schoenherr.eu

schoenherr

1. General

1.1 Governing Law

The construction market in Austria is mainly governed by the Austrian General Civil Code (see Articles 1165 et seq of the Austrian General Civil Code – *Allgemeines bürgerliches Gesetzbuch* – ABGB and www.ris.bka.gv.at).

1.2 Standard Contracts

The use of certain standard contracts is generally not mandatory in Austria. Only in public procurement procedures is the application of ÖNORM B 2110 issued by Austrian Standards International obligatory (deviations are possible if there are compelling reasons). However, the parties to a construction contract (in any constellation, including employer-contractor, contractor-subcontractor, etc) frequently use the general terms and conditions of ÖNORM B 2110 issued by Austrian Standards International as a basis and agree on deviations in the individual contract. The use of the FIDIC standard forms is limited to projects where the European Bank for Reconstruction and Development or another sponsor demands that the contract is concluded under these terms.

2. Parties

2.1 The Employer

In Austria there are mainly the following types of employers:

- developers who build with the aim to have an exit upon finalisation;
- institutional investors such as real estate funds and family offices;
- private owners; and
- public bodies in connection with infrastructure projects.

For the execution of the construction work, the owner mainly enters into a contract with a general contractor who, in turn, uses subcontractors.

Rights and Obligations

The rights and obligations of the employer are determined by the specific contract, by the frequently used general terms and conditions ÖNORM B 2110 and by the Austrian General Civil Code (Articles 1165 et seq). The employer's primary duty is the payment of the price within the specified timescale against delivery of the finished building. The construction agreement normally also covers the transfer of intellectual property rights so that finishing and altering the building is possible without further consent.

2.2 The Contractor

Generally speaking, master builder companies act as general contractors and subcontract specialists such as electricians or HVAC companies. There are a few large companies (some of them listed) who work throughout Austria (and in the wider CEE/SEE region) and a vast number of "mid-sized local heroes". It is common that where buildings are constructed for an institutional investor, the developer who sells the building also takes the role of the engineering, procurement and construction (EPC)-contractor so that the investor has just one point of contact and in turn subcontracts planners and a general contractor.

Both general contractor models and EPC-models are widely used.

In the general contractor model, the owner uses an architect and an engineering team for the planning. Normally, the owner has a single planning contract with a main planner/designer and only concludes contracts with specialised planners for statics, building physics, etc. For the

execution of the construction work, the owner concludes a contract with a contractor who, in turn, uses subcontractors.

In the EPC-model, the owner contracts with a single company that assumes full responsibility for the planning and realisation of a project.

Rights and Obligations

The rights and obligations of the contractor are again determined by the specific contract, by the frequently used general terms and conditions ÖNORM B 2110 and by the Austrian General Civil Code (Articles 1165 et seq). The contractor's primary duty is to deliver the completed building; it does not need to do the work itself but is free to use – under its responsibility – subcontractors. The agreement normally also covers other duties, such as the duty of loyalty, transfer of intellectual property rights, and obligation to have adequate insurance.

2.3 The Subcontractors

In Austria, subcontractors are typically mid-sized to small companies that specialise in a particular field.

There is usually only a contract between the EPC/general contractor and the subcontractors, but not between the subcontractors and the employer (however, the employer normally also has the right to take over the subcontracts if its contract with the EPC/general contractor is terminated). This contract is typically a contract for work and services in which the contractor assumes the role of the employer and the subcontractor takes the place of the contractor, so the same rights and obligations as listed in **2.2 The Contractor** apply.

2.4 The Financiers

Typically, construction projects are financed by banks, insurance companies or real estate funds. For this purpose, the developer takes out a mortgage loan with the respective bank and undertakes to repay it in one amount after the finalisation of the works and exits the arrangement by selling the building. Most financing contracts in this field provide for a flexible interest rate and the payment of interest during the term and the capital at the end.

2.5 The Designer

Generally, designers are smaller firms owned by planners.

General planner models are most often used. In the general planner model, the employer uses only one architect for the planning. This general planner then concludes contracts with specialised planners for statics, building physics, etc, and also with specialists for the supervision of the building works.

The main obligation of the planner is the planning based on the requirements from the employer and obtaining the necessary permits. The planner is responsible for the project's success in this regard – ie, that the plan both fulfils the requirements of the employer (eg, a hotel with 100 rooms, a restaurant and a spa) and the legal requirements to obtain the necessary permits. The supervision part of the roles has more elements of a service contract. In addition, in all contracts the transfer of the relevant intellectual property rights is agreed upon.

3. Works

3.1 Scope

In Austria the scope of the works in construction contracts is either determined based on a detailed list of construction works or on functional definitions of the works. Sometimes employers use a combination of the two by defining functional requirements which must be reached as a minimum and then adding a list of construction works for which the contractor is responsible and where the contractor takes the risk as to whether the list is sufficient to fulfil the functional requirements.

3.2 Variations

The law does not contain a right for the employer to demand variations of or changes to the scope of the works. Therefore, construction contracts regularly contain specific provisions for change orders. ÖNORM B2110 contains specific provisions on the procedure for changes and for the effects of the change request on the price and timeline.

Usually, it is agreed that the same calculation principles that were applied to the original contract (even for fixed, flat-rate prices where the detailed calculation is not disclosed) shall also apply to any changes/variations – meaning a good price shall remain a good price. However, extension of time above a threshold normally contractually entitles the contractor to apply indexation to the prices.

3.3 Design

Usually, planners are responsible for all design works and supervision of the works. However, there are also other models.

General Contractor Model

In the general contractor model, the owner uses a planner for the planning. The owner normally concludes a contract with a general planner who then concludes individual contracts with specialised planners for statics, building physics, etc, and also with specialists for the supervision of the building works involved. For the execution of the construction work, the owner enters into a contract with a contractor who, in turn, mandates subcontractors.

EPC Contractor Model

In the EPC contractor model, the owner contracts with a single company that assumes full responsibility for the planning and realisation of a project.

3.4 Construction

The responsibilities regarding the construction process depend on the model used in the construction process.

In the EPC model, the general contractor (the “EPC-contractor”) is solely responsible for all works, as there is no contractual relationship between the employer on the one hand and the subcontractors and suppliers on the other. If the work is individually allocated, the employer has direct contracts with the craftsmen. The contractor is responsible for the construction process, and the employer must supervise the project and in the case of individual allocation of the works must also co-ordinate the different work streams.

If the contractor is managed and supervised by the architect, the architect is responsible for the management of all works and each contractor for its specific portion of work.

3.5 Site

The responsibility for the status of the construction site (eg, regarding pollution, underground obstacles, geotechnical conditions or archaeological finds) lies by law with the employer as the land is the part of the works which the employers provide to the construction company to construct the building.

However, it can be agreed to a certain extent that the EPC-contractor is responsible for the status of the construction site. The test is whether the risk that the EPC-contractor takes can be calculated (eg, because it was in a position to conduct soil tests or has been provided with an expert opinion on the status). Also, a certain amount of contamination is normally accepted and has to be borne by the contractor and only contamination above this threshold cause extra costs to the employer.

Statutory law provides for additional specific obligations for contractors (eg, correct handling of decontamination works), but the remuneration for such works is agreed in the construction contract and normally paid by the employer.

3.6 Permits

With few exceptions, all construction works are subject to building permits, and for buildings used as production sites, an operating permit under Austrian trade law is also required before the start of the building works. If additional permits are required (eg, based on the Water Rights Act or Environmental Protection Act), the authority must as a basic rule co-ordinate all permit procedures. For large-scale projects, an environmental impact assessment might be required.

By law, the landowner is responsible for ensuring that all necessary permits for the construction measures have been issued. However, typically,

the architect or the EPC-contractor is contractually responsible for obtaining the necessary permits.

3.7 Maintenance

There are no specific maintenance provisions for contractors under Austrian law. The employer is free to mandate any contractor of its choice for maintenance works. However, certain contractors typically agree to extend guarantee periods (eg, for the roof or façade or technical equipment), provided that the employer enters into a maintenance agreement with them.

3.8 Other Functions

Employers for large-scale projects typically hire, alongside the architect, project managers who manage and supervise the entire project and take over the administrative tasks.

3.9 Tests

In Austria, there are no general testing obligations for construction works. Typically, testing is part of the acceptance procedure agreed in the contract and must be prepared, organised, and performed by the architect and/or the contractor.

For some technical equipment – such as elevators, electric installations or chimneys – the authority requests certain acceptance procedures by qualified individuals. Furthermore, the architect must confirm in writing to the authority that the building has been constructed according to the permits and submit the necessary confirmations of the acceptance tests to the competent authority of the local community before the project can be inhabited or used for its intended purpose. An official inspection of the project is undertaken only if there are doubts with respect to the submitted documentation.

3.10 Completion, Takeover and Delivery

Typically, the acceptance procedure proceeds as regulated in ÖNORM B2110, whereby the contractor invites the employer to a joint acceptance. In the case of major defects, the acceptance fails. Minor defects must be reported and repaired within a reasonable period of time.

Takeover can also take place before acceptance. However, this involves risks regarding defects, as it may be construed as a waiver in relation to defects and may, from a technical point of view, complicate the allocation of responsibility for defects.

3.11 Defects and Defects Liability Period Defects Liability Period According to the Austrian General Civil Code

According to the Austrian General Civil Code there is no obligation for the employer to inspect the quality of the work after delivery and inform the contractor of any defects as the respective provision only applies to moveable goods and not to buildings or works on immovable property. Nevertheless, in many construction contracts an inspection obligation is included and it is agreed that if the employer fails to carry out the inspection, it implicitly approves recognisable defects.

For construction works, the limitation period is generally three years from acceptance of the work, subject to interruption of the limitation period (eg, by filing a claim). After three years, defects can still be claimed under Austrian damage law, which provides for a prescription period of three years after the defects become known to the employer (ten years after acceptance of the work).

However, parties are free to agree on different provisions. In most cases the period for certain

works such as load-bearing walls and roofs is extended to ten years, whereas the possibility to claim defects under damage law is also reduced to three years after acceptance.

4. Price

4.1 Contract Price

As consideration for the services performed by the contractor, prices are usually agreed on the basis of the amount of time spent and material used (*Regiepreise*), or as unit prices (*Einheitspreise*) or fixed prices (*Pauschalpreise*).

Unit Prices

Unit prices determine the consideration for individual services that are listed as separate items in the schedule of services. They are defined for the individual units of quantity, so that the consideration owed for a service is computed after its completion. The quantities of services performed at unit prices are determined according to the terms of the construction contract, in accordance with their actual measure (by measurement, weighing or counting) or with their theoretical measure based on the underlying designs. Unit prices might change if the unit which has been basis for the calculation deviates significantly (as a rule of thumb more than 20%) from the units actually built.

Fixed prices

A fixed price may be agreed for individual services, for part of the project or for the entire project carried out by the contractor. Fixed prices should only be agreed upon on the basis of complete and clear documentation (ie, detailed project specifications, designs, etc).

Fixed prices can also be subject to price adjustment clauses.

Milestone Payments

Milestone payments are typically agreed on by the parties, with payments on account.

4.2 Indexation

For building projects expected to be completed within to two years, indexation clauses are rarely used. In partnership models, however, defined parts (eg, steel) are usually exempted and subject to indexation from the start of the project. If the time for the construction is longer it is common practice to agree on indexation after a certain threshold period. In those periods for which no indexation has been agreed, the risk of large price fluctuations is borne by the contractor.

4.3 Payment

There are various concepts to prevent late or non-payment in construction contracts. Typically, the parties agree on a payment schedule consisting of milestone payments, to be paid on account. There can also be advance payments, which are typically secured by a bank guarantee.

Section 1170b of the Austrian General Civil code provides that the contractor of a building may demand security from the employer for the outstanding payment up to the amount of one fifth of the agreed payment, but up to the amount of two fifths of the agreed payment for contracts to be fulfilled within three months. This right cannot be waived. The contractor shall bear the costs of the collateral provided that they do not exceed 2% of the collateral amount per year. Securities pursuant to this provision shall be provided within a reasonable period to be determined by the contractor. If the employer fails to comply with the contractor's request to provide security, the contractor may refuse performance and declare the contract void, setting a reasonable grace period (which leads to the fact that the contractor may claim the whole price minus

what it has actually had to spend). This is, therefore, an extremely effective tool for the contractor to secure payments. However, this provision does not apply if the employer is a consumer or a public entity (state, counties, cities).

4.4 Invoicing

Typical billing methods used in construction contracts in Austria are payments on account (milestones) and final payment. Invoices are then sent to, and reviewed by, the company instructed with the supervision of the construction works.

5. Time

5.1 Planning and Programme

There are typically the following planning phases in construction projects:

- strategic planning;
- preliminary studies;
- design planning;
- submission planning;
- invitation to tender;
- implementation planning;
- finalising planning; and
- supervision.

The architect/planner is instructed with all steps until invitation to tender and the supervision (unless a third party is separately engaged for supervision), whereas the construction company is responsible for the implementation and finalisation of the planning.

In most cases, there is a construction schedule that sets specific dates indicating milestones that must be reached by certain dates which is linked to a payment schedule based on the degree of completion. Contractual penalties are

usually agreed to enforce compliance with the deadlines.

5.2 Delays

The construction schedule is often declared as binding.

The contractor has the right to an extension of the contractual performance period for a reasonable period if the execution of the project is delayed for a reason that is the employer's responsibility. If the contractor is responsible for the delay, or if the reason for the delay cannot be ascribed to either party, (eg, acts of God, wars or pandemics), the risk is borne by the contractor. ÖNORM B2110 shifts the risk to the employer when the reason for delay cannot be ascribed to either party. The employer and the contractor are liable to each other for damage resulting from exceeding the agreed construction schedule.

For cases in which contractual performance periods are exceeded, the contractor agreement typically provides for reasonable penalties, which are, however, not owed where the contractor is entitled to an extension of performance periods. Also, the construction contract typically provides that a contractually stipulated penalty shall not constitute a release from remaining contractual obligations but shall be accounted towards the payment of any damages owed.

In the event of delays caused by the contractor, where there is no longer any prospect of completing the work on time, the employer has the right to withdraw from the contract without waiting for the agreed delivery date.

5.3 Remedies in the Event of Delays

In the event of delays, the employer is entitled to claim damages (eg, loss of rental income, reimbursement of damages claims from tenants who

have been promised a certain delivery date, or longer payment of interest on a bank loan) and the right to rescind from the contract after having set an adequate grace period.

Typically, contractual penalties are agreed in the event of delays in order to make it easier for the employer to prove the actual damage. However, such damages may not exceed 5% of the price actually owed to the contractor. Excess damages may be claimed if the employer can prove their amount.

5.4 Extension of Time

If it is likely that the execution of the project will be delayed through no fault of the employer, the contractor must make additional arrangements in order to prevent further delays, such as increasing the size of the workforce or putting on additional work shifts. If the execution of the project is still delayed, the employer has the rights described in **5.3 Remedies in the Event of Delays**. If the delay is without fault on the side of the contractor, the employer cannot claim damages or penalties; however, the burden of proof that there is no fault lies with the contractor.

An extension of time is only possible for the contractor if the delay is caused by the employer.

However, in the construction contract, it is normally agreed that in certain cases the contractor has an entitlement to the extension of the performance periods.

5.5 Force Majeure

Austrian law does not expressly regulate force majeure, but this principle is nevertheless recognised in case law. If performance has become impossible due to circumstances for which the debtor is not responsible, the claim is considered

extinguished. The debtor is no longer obliged to perform.

As part of the contractual freedom prevailing in Austrian private law, the parties involved may contractually extend or restrict the statutory scope of the application of force majeure. Such clauses chosen by the contracting parties generally override the subsidiary provisions of Austrian law. Many contracts and general terms and conditions contain a force majeure clause, according to which, for example, pandemics, official restrictions or other unexpected occurrences are to be qualified (or not) as force majeure.

Contractual force majeure clauses usually also contain provisions on the legal consequences (termination, liability for damages or grace periods) of late performance or non-performance due to the event that has occurred, if there is a causal connection.

5.6 Unforeseen Circumstances

Construction companies are trying to use the argument that the COVID-19 pandemic and the war in Ukraine constitute force majeure events, and that they are therefore entitled to a change in – ie, an increase of – agreed lump-sum prices and fixed unit prices as well as an extension of the construction period, even for existing contracts. It is highly probable that the risk of force majeure in construction contracts based on the Austrian General Civil Code must be borne by the construction company, whereas if the Austrian standard ÖNORM B2110 has been agreed for the construction contract, this risk must be borne by the employer.

However, these examples have led parties including clauses in construction contracts which shift or apportion such risks. This requires that construction companies do not just want

to shift the risk to the employers, employers understand the request and solutions such as partnership-models are found.

5.7 Disruption

Disruption understood as a loss of productivity due to a hindrance or interruption of the progress of the construction works, which reduces the rate of efficiency, is generally not acknowledged as a specific legal and/or contractual reason for extension of time and/or compensation. Such disruptions are normally treated the same way as delays (see 5.2 Delays).

6. Liability

6.1 Exclusion of Liability

According to mandatory law in Austria, it is not possible to exclude liability for:

- wilful misconduct or gross negligence for consumers and wilful misconduct or flagrant gross negligence for non-consumers;
- a claim under the product liability act; and
- damage to a person.

6.2 Wilful Misconduct and Gross Negligence

See 6.1 Exclusion of Liability.

6.3 Limitation of Liability

Within the framework described in 6.1 Exclusion of Liability, the limitation of liability is possible. Consequently, liability for slight negligence can be excluded in a contract with respect to damages to goods and rights (not to a person). The entire system of liability within this framework is dispositive (there are further exceptions for consumers, such as no change of the burden of proof); there is a broad scope for drafting contractual limitation of liability. Usually, liability

is limited to a certain amount, especially to the amounts of the insurance cover of the contractor. Furthermore, it is often agreed to limit liability to foreseeable damages and to exclude indirect damages. Loss of income is also sometimes excluded. The latter exclusion of certain types of damages, however, faces the risk of being deemed to violate *bonus mores* and to be void.

7. Risk, Insurance and Securities

7.1 Indemnities

Indemnities are generally used to limit risks to the employer. Typical subjects would be damage/loss of profit due to delays and third-party claims (eg, damage to the neighbouring property due to the construction works or claims of tenants to reduce the rent due to disturbance during construction works).

7.2 Guarantees

Employers are typically granted the following in the form of an abstract, irrevocable guarantee within the meaning of Section 880a of the Austrian general Civil Code from a major Austrian bank or insurance company (some employers also accept German banks and insurance companies):

- a pre-payment guarantee (*Anzahlungsgarantie*) to secure down payments at the beginning of the works;
- a performance guarantee (*Fertigstellungsgarantie*) securing all obligations of the contractor under the contract (eg, reimbursement of excess payments, costs for substitute performance by the customer in case of early termination of the contract, etc);
- a guarantee to free the usual deductions of 10% from milestone payments (*Deckungsrücklassgarantie*); and

- a warranty guarantee (*Hafrücklassgarantie*) securing the contractor's liability for defects.

The contractor has the right to demand a payment guarantee in order to secure payment of the agreed price (see 4.3 Payments).

7.3 Insurance

Master builders are obliged by law to have third-party liability insurance with a minimum cover per case and per year depending on the size of the company. Architects must also have such an insurance; however, the minimum cover is very low.

Typically, the contracts provide that the parties must take out the following insurance cover:

- the architect or the EPC/general contractor demand that the employer has sufficient insurance coverage for third-party damages and for defects of existing buildings and installations (*Bauherrenhaftpflichtversicherung*); and
- the employer demands that the contractor insures the work in progress (*Bauwesenversicherung*).

7.4 Insolvency

In the event of bankruptcy of a contractor, the court-appointed receiver may choose whether to finalise the works or terminate the contract. The employer has no special right to terminate the contract early, but has to rely on the termination rights for delays and non-performance. It is also not possible to agree that the employer is granted the right to terminate the contract early in the event that insolvency proceedings are begun. However, it is possible to agree on a termination right if there are certain financial difficulties on the part of the contractor (eg, a reduction of its credit under a certain threshold

or liquidation of parts of the company) before the opening of bankruptcy proceedings.

In addition, contracts often include a right for the employer to make direct payments to subcontractors that will be deducted from the contract price if the contractor does not pay its subcontractors on time.

Regarding financial difficulties of the employer, contractors have the right to suspend their works if they are not paid on time. With respect to the right to withdraw from the contract the same principle as for the contractor apply.

7.5 Risk Sharing

The concept of sharing risks in a construction contract is becoming increasingly common in Austria.

Based on a partnership model, the total price of the general contractor is split into the costs that the construction companies expect for the individual trades to be awarded to subcontractors. As soon as the actual award to the subcontractors then takes place, any negotiation success of the general contractor is split between the construction company and the employer – usually in a ratio of 50:50. On the other hand, any increase over the prices disclosed for the subcontractors (usually up to a maximum amount) is split in a ratio more favourable to the employer (for example, 80% of the increase is borne by the construction company and 20% by the employer).

In addition, fixed prices are also increasingly being split into the individual cost types on which the calculation of the unit price or lump sum price is based. Fixed prices continue to be agreed for components that can still be calculated in principle, such as wages and central overheads. In contrast, for materials, where

prices have been very volatile in the recent past, only price escalators will be agreed. This allows price changes for the items whose prices are most difficult to estimate to be passed on to the employer, which also benefits the chance that a market, which is currently overheated for some materials, will calm down again.

8. Contract Administration and Claims

8.1 Personnel

There are various mandatory provisions for a contractor's personnel (work security, laws on dismissing employees, laws on minimum wages, laws on employment of foreigners, laws on social security, etc). While the employer may only be held responsible in some cases if the contractor does not observe such requirements, doing so will in any case have a negative impact, from both an economic (because the authority stops the construction) and a reputational perspective. Therefore, all construction contracts contain a provision to the effect that the contractor must comply with all these mandatory provisions and which indemnifies the employer in the case of a violation. Furthermore, such violation is also agreed to provide a right for early termination.

In addition, contracts often include provisions regarding key personal and their replacement, as well as the right of the employer to request that the contractor exchanges a specific person for rendering the works.

8.2 Subcontracting

In Austria the contractor is free to enter into subcontractor agreements. Except for public procurement, where this needs to be disclosed and agreed upfront, the contractor is also free to sub-contract the entire scope of the works.

However, contractors are responsible for ensuring that their subcontractors observe the statutory laws on works security, dismissing employees, minimum wages, employment of foreigners, social security, etc.

Employers often reserve the contractual right to approve subcontractors or to reject a named subcontractor for good reasons. Sometimes they also reserve the right to require the engagement of certain subcontractors.

8.3 Intellectual Property

Typically, contracts include a clause on the full assignment and transfer of all work results and other intellectual property rights to the employer.

9. Remedies and Damages

9.1 Remedies

In the event of a breach of the construction contract, Austrian law provides for a variety of remedies for the different parties involved.

For the employer, the most important remedies are rescission, reduction of the price or rectification of the defect. In principle, the employer must demand rectification of the defects capable of being rectified as a first priority and only subsequently choose which claim to pursue. Rectification costs are borne by the contractor but they can deny rectification if it is excessive.

In addition to the rights in terms of defects, the employer may also claim compensation for any damage caused by a defect, to the extent the contractor is at fault (whereby the contractor has the burden of proof that it acted without fault).

For the contractor, the most important remedies are the right to demand security for the payment

of the agreed price (see **4.3 Payment**), the right to stop the works temporarily, and the right to rescind the contract and demand payment of the price minus actual savings.

The subcontractor has no contractual relationship with the employer and so claims for breach do not apply.

9.2 Restricting Remedies

It is common practice in Austria to contractually limit remedies. For example, it can be agreed that the contractor may choose whether to rectify or grant a price reduction (only for businesses).

9.3 Sole Remedy Clauses

It is also common practice to limit the remedies contractually to reduction or rectification (and to exclude rescission).

9.4 Excluded Damages

It is often agreed to limit liability to foreseeable damages and to exclude indirect damages. Sometimes loss of income is also excluded. The exclusion of certain types of damages faces, however, the risk of being deemed to violate *bonus mores* and to be void. The same is true of the exclusion of liability for wilful misconduct and gross negligence in these cases.

9.5 Retention and Suspension Rights

It is often agreed that the contractor is not entitled to a retention right for the building, but has to hand over the building and cannot keep it as security for payment of the remaining price. On the other hand, it is always agreed that the employer has a retention right to keep 10% of the milestone payments as security for the performance of the contractor's obligations until acceptance of the building.

9.6 Termination

For as long as the project has not been completed, the employer may terminate the construction contract at any time in exchange for payment of the full price minus expenses saved by the contractor as a result of the employer's termination. Here it is often agreed that in such a case the employer only has to pay the value of the (unfinished) building works already performed (and thus saves the calculated profit of the contractor on the remainder).

10. Dispute Resolution

10.1 Regular Dispute Resolution

Disputes of up to EUR15,000 are decided by the local district courts (*Bezirksgerichte*), disputes above this threshold by the county courts (*Landesgerichte*). Only Vienna has specialised courts in commercial matters (*Handelsgericht/Bezirksgericht für Handelssachen*) which would be responsible for ruling on contractual disputes against businesses.

10.2 Alternative Dispute Resolution

Even though arbitration is possible for businesses in both domestic and international matters in Austria, arbitration clauses are typically found only in contracts regarding large or complex projects involving international parties. The Austrian Civil Procedure Code provides for detailed rules on arbitration which apply besides the rules of the arbitration institution chosen. For consumers, arbitration is only possible for a specific, already existing dispute.

Although arbitration courts in Austria also offer and promote mediation, it is rarely seen in Austrian practice because of the good reputation of the state courts and arbitration tribunals when it comes to resolving construction disputes by way of settlement.

Trends and Developments

Contributed by:

Constantin Benes, Peter Madl and Franziska Oczlon
Schoenherr

Schoenherr has a solid footprint across Central and Eastern Europe with a strong local presence in 14 countries and a global reputation for its high-end capability across CEE/SEE. The firm's real estate and construction practice continues to enjoy solid growth in Austria and CEE/SEE. Schoenherr's construction team is headed by Constantin Benes and supported by Peter Madl, who has decades of experience and Franziska Oczlon, who is also a qualified architect. The team advises not only high-profile clients on large-scale projects within the energy,

environment, infrastructure and waste management sectors, but also pre-eminent real estate developers on the planning, development and construction of residential, office and retail spaces. The team also focuses on advising clients on post-construction litigation as well as litigation in connection with general construction matters. The team's extensive expertise is complemented by know-how provided by lawyers' cross-practice, especially the firm's real estate and regulatory experts.

Authors



Constantin Benes is a partner with Schoenherr in Vienna and heads Schoenherr's construction team. He specialises in construction law with a particular focus on

industrial facilities as well as the development of housing and office projects, including construction litigation. A further focus of his expertise includes lease contracts, as well as securitisation in connection with reorganisations of financing. Constantin is the author of numerous publications focusing on all areas of real estate and commercial civil law and recently co-authored a section of a practice commentary on tenancy law. He studied in Graz, Austria and at Columbia Law School, New York.



Peter Madl plays a central role in Schoenherr's property-related mandates in Austria and CEE. With an outstanding track record of high-end transactions, he is well equipped to advise Austrian

and international investors on their property dealings in the region. His activities have a strong focus on real estate development and advice with respect to all types of construction contracts for infrastructure projects, shopping centres, condominiums and production sites. He is also very experienced in construction litigation. Peter is a graduate of the University of Vienna (Dr.iur.) and the Vienna University of Economics (Mag.rer.soc.oec.) and he lectures on real estate law at the University of Vienna.

Contributed by: Constantin Benes, Peter Madl and Franziska Oczlon, **Schoenherr**



Franziska Oczlon is both an attorney and a diploma engineer. She thus fits Schoenherr's construction practice, where she focuses on development and infrastructure projects, perfectly.

She graduated from the University of Vienna (Mag. iur.) and Vienna University of Technology (Dipl. Ing.). Before joining Schoenherr, she worked as an architecture graduate at an architectural office.

Schoenherr

A-1010 Vienna
Schottenring 19
Austria

Tel: + 43 1 534 37 50231
Fax: +43 1 534 37 66231
Email: c.benes@schoenherr.eu
Web: www.schoenherr.eu

schoenherr

Introduction to Construction Law Trends in Austria

The construction sector in Austria, like many others around the world, is subject to a variety of influences that shape its legal and operational landscape. Clients looking to engage with this sector must navigate a complex array of issues that are currently notable in the market. This chapter aims to provide a concise account of these issues, focusing on the legal restrictions on bank financing, the impact of increased building and financing costs, and the implications for developers initiating projects.

Legal Restrictions on Bank Financing for Consumers

A significant development in Austrian construction law is the implementation of the KIM-ordinance (*Kreditinstitute-Immobilienfinanzierungsmaßnahmen-Verordnung*), which imposes stricter regulations on bank financing. This ordinance has been introduced to ensure the stability of the financial market by requiring more rigorous creditworthiness checks for private borrowers in connection with real estate financing. The implications for individuals seeking bank finance are profound.

Stricter credit assessments

Banks are now mandated to conduct more detailed assessments of a borrower's financial situation, which has led to a significantly lower approval rate for construction loans. The total monthly payment (interest and capital) may not be higher than 40% of the net income of the borrower in order to ensure that the borrower has sufficient funds for the basic needs of living after having paid the instalment to the bank.

Reduced loan-to-value ratios

The ordinance provides for a lower maximum loan-to-value ratio, meaning individuals must

provide a down payment of at least 10% of the assessed value, as well as the real estate transfer tax and the land registrations fees to secure financing. So, the maximum amount a bank may finance is 90% of the assessed value, which in practice means that a potential purchaser must be able to finance approximately 20% of the total costs out of savings. In order to mitigate the negative effects, the Austrian government has decided to temporarily waive the land registration fee for title of 1.1% and for mortgages of 1.2% for the purchase of the main residence up to an amount of EUR500,000 (if the purchase price is between EUR500,000 and EUR2 million only the first EUR500,00 are free, if the purchase price is above EUR2 million the waiver does not apply at all).

Reduced maximum loan duration

The maximum allowed duration of a loan is 35 years.

Exceptions

Banks are entitled to grant exceptions from the above restrictions for a relatively low percentage of all new loans granted.

Impact on demand

These restrictions have led to a sharp decrease in demand for construction projects as potential buyers find it more challenging to secure the necessary funds. This is one of the reasons why developers are hesitating to start new projects and thus to instruct construction companies.

Counter measures

As the building industry has run into serious problems due to decreased demand from private buyers, the Austrian government has launched a programme "Residential Billion" that, inter alia, makes it possible for the Austrian provinces to grant (i) loans of up to EUR200,000 at an inter-

est rate of only 1.5%, and (ii) subsidies of up to EUR2,000 per person for any renovation works within the own apartment (“craftsman bonus”).

Increased Building Costs

The construction industry is also grappling with increased costs, which have caused a ripple effect throughout the sector.

Rising material costs

Global economic trends and supply chain disruptions have led to higher prices for construction materials, which directly increase the overall construction costs.

Higher labour costs

Austria had one of the highest inflation rates in Europe and still has an inflation rate nearly twice as high as the average inflation rate in the European Union. Unions have succeeded in negotiating wage increases of around 10%. Furthermore, there is a shortage of skilled labour in the construction industry which resulted in a further increase of wages, adding even more cost pressure on construction projects.

Due to the high inflation rate (after the rate peaked at over 10% in 2022 and 2023, Austria still had an inflation rate of 4.1% in March 2024), the increase in interest rates and the volatility of prices for raw materials, construction companies have not been willing to conclude fixed price, lump sum agreements throughout 2022 and 2023 but have merely offered index-linked prices or – as a best case from an employer’s perspective – partnership models with (partly) open calculations where a part of price increases and decreases is shared between the parties. As developers have therefore stopped or at least delayed their projects, the demand for construction has decreased sharply. Hence, construction

companies are again taking more risks and have started to offer fixed price contracts again.

Increased Financing Costs

Not only have the effects of the KIM-ordinance impacted buyers’ hunger for new developments, the significant rise in interest rates has also reduced developer’s willingness to start new projects. Interest rates of 5–6% are additional costs which a developer must include in its sales price and therefore significantly impact its calculations.

Rising Costs and Lower Demand Threaten the Creation of Housing

The current market environment leads to multiple challenges for investors.

First, they are faced with sharply increased construction costs and – still in a considerable proportion of construction projects where the construction company is not willing to agree on a lump sum, fixed price contract – are not able to provide (potential) financiers with clear estimates of the construction costs. Therefore, often only the basic costs for a development can be financed. The developers must thus increase their equity share to cover cost overruns and increases of variable construction prices.

Second, investors face a sharp increase in interest rates – both fixed as well as flexible interest rates. It was market practice to finance construction costs by taking out variable loans in order to be able to repay the loan according to the progress made in selling off the apartments or the project. Proceeding this way was not very risky as long as interest rates remained stable at a very low level. The risk linked to this practice has now increased significantly due to the interest rate increases implemented by most central banks (NB, which is how it should be, but

the real estate market had lost the feeling that money has a price tag) leading to significantly costlier loans.

On the other hand, the prices for building plots and real estate in general have not yet decreased but remain at (or close to) the high levels reached in the past boom years. This is, inter alia, a consequence of financing banks still not enforcing their rights and selling off pledged real estate as they fear the potential losses if the respective properties were sold today. These financing banks therefore currently often grant extensions of repayment plans as they hope that the real estate market will recover and the developer can then finalise the project and sell it at a price exceeding the outstanding loan. However, since the beginning of 2024, Austrian banks have started to clean up their portfolios and put pressure on developers to sell off real estate, even below the purchase price. Some have even gone as far as to apply for insolvency proceedings. The increase of the plots for sale as well as a decrease of the number of developers having sufficient equity will now likely lead to price decrease and thus make more projects feasible.

In addition, market prices for the final product – whether sold to a fund as an investment or to an individual for living and/or investment purposes – have not increased but rather slightly decreased. Institutional investors are also currently reducing their exposure in real estate as higher interest rates make alternative investments other than real estate more attractive.

These developments have led to developers reducing their activities (and also reducing their expectations as to the ROI on their equity). Employers are therefore currently not seeing sufficient profit or are even contemplating the risk of a loss with regard to new projects. Thus, the

Austrian construction industry has come to a de facto standstill. In Vienna alone, the construction of new apartments is expected to decrease until 2025 by over 50% (despite the fact that the city is still growing). For the time being construction companies have idle capacities. The effects of this can already be seen in the market as big construction companies are bidding for smaller projects and smaller companies are lowering their prices. This is also leading to the pricing models the construction companies offer moving towards co-operative partnership models (where the employers participate in the risk of price development during the construction period). On the other hand, lump sum fixed-price agreements are also being offered again.

Sustainability and Environmental Considerations

Sustainability has become a central topic in construction law, with a growing emphasis on green building practices and compliance with environmental regulations. The Austrian government has implemented various initiatives to promote energy efficiency and reduce carbon emissions in the construction sector. Clients must be aware of the legal requirements for environmental impact assessments (EIA) and the need to obtain necessary environmental permits before commencing construction projects.

Currently, a major topic of discussion is whether and when an EIA shall also be mandatory for the development of residential and office buildings by different landowners who each only own a piece of land which is below the threshold for an EIA. This is particularly discussed in connection with larger developments where real property – often owned by public entities – is to be redeveloped (eg, former railway stations in Vienna to be changed into mixed use developments). An EIA certainly delays that development by years and

also poses the risk that additional measures to protect animals and plants will have to be taken into account, also leading to cost increases.

New requirements for the careful use of natural resources are being implemented on a large scale, in particular across the EU. Hence, more and more companies are subject to the EU Taxonomy Regulation and are forced to think about their ecological footprint. Existing buildings as well as new buildings to be constructed must be as resource efficient as possible over their entire life cycle. This trend is being pushed by legal regulations coming from the EU as well as by (institutional) real estate investors requiring that real property they invest in fulfil the highest certification standards. Furthermore, potential tenants directly profiting from energy efficient buildings are increasingly taking energy efficiency into their considerations when choosing which apartment/building to rent. Accordingly, buildings begin to lose value simply because they are not energy efficient and/or sufficiently certified. Owners are therefore prepared to accept additional costs with respect to refurbishing existing buildings as opposed to selling those buildings at a discount.

In addition, investing in energy efficiency has an immediate effect, lowering the operating costs right away, and tenants are focusing more and more on the overall costs of using real property instead of just looking at the rent. Even if this may not yet be reflected in higher rents at the moment in every market, even today easier “letability” and thus better occupancy make such an investment worthwhile.

This trend can also be seen from an increase of ESG-related construction work partly offsetting the decrease in construction work concerning new buildings.

Digitalisation and Technological Innovation

The adoption of digital technologies is reshaping the construction industry in Austria. Building information modelling (BIM) is increasingly becoming a standard practice and its use may soon be mandatory for certain public projects. Clients should be prepared to integrate BIM into their operations and understand the legal implications, including issues related to intellectual property and data protection. Currently the downside is that there are still a vast number of BIM systems on the market and nearly every construction company uses a different system. These systems also still show deficiencies, making it difficult for employers, architects, general contractors and subcontractors to work together and co-operate seamlessly. Transferring the information to a facility manager after completion of the building to facilitate future maintenance works is also still an issue, leaving room for improvement. However, great progress has already been made and it is a surely only a few years until BIM will be a normal tool used for every building.

Further, the authorities are making progress in terms of digitalisation as Austria is a frontrunner in digitalisation of permitting procedures. An example is Vienna where fully digitalised applications for building permits can be filed and the communication between applicants and the authority is made on the platform mein.wien.at so that all involved parties have the same knowledge, and nothing can get lost.

Conclusion

The current trends and developments in the Austrian construction industry present a complex picture for clients interested in the sector. The KIM-ordinance has introduced tighter controls on bank financing, leading to a dampened demand for new construction. Simultaneously,

AUSTRIA TRENDS AND DEVELOPMENTS

Contributed by: Constantin Benes, Peter Madl and Franziska Oczlon, **Schoenherr**

developers are contending with higher building and financing costs, necessitating innovative approaches to project initiation and funding. Clients must stay abreast of these evolving dynamics to make sound strategic decisions in the Austrian construction market.

BANGLADESH

Law and Practice

Contributed by:

Sharif Bhuiyan and Reduanul Karim

Dr Kamal Hossain and Associates



Contents

1. General p.35

- 1.1 Governing Law p.35
- 1.2 Standard Contracts p.36

2. Parties p.37

- 2.1 The Employer p.37
- 2.2 The Contractor p.38
- 2.3 The Subcontractors p.39
- 2.4 The Financiers p.39
- 2.5 The Designer p.40

3. Works p.40

- 3.1 Scope p.40
- 3.2 Variations p.40
- 3.3 Design p.41
- 3.4 Construction p.41
- 3.5 Site p.41
- 3.6 Permits p.42
- 3.7 Maintenance p.42
- 3.8 Other Functions p.43
- 3.9 Tests p.43
- 3.10 Completion, Takeover and Delivery p.43
- 3.11 Defects and Defects Liability Period p.43

4. Price p.44

- 4.1 Contract Price p.44
- 4.2 Indexation p.44
- 4.3 Payment p.44
- 4.4 Invoicing p.45

5. Time p.45

- 5.1 Planning and Programme p.45
- 5.2 Delays p.45
- 5.3 Remedies in the Event of Delays p.45
- 5.4 Extension of Time p.45
- 5.5 Force Majeure p.46
- 5.6 Unforeseen Circumstances p.46
- 5.7 Disruption p.47

6. Liability p.47

- 6.1 Exclusion of Liability p.47
- 6.2 Wilful Misconduct and Gross Negligence p.47
- 6.3 Limitation of Liability p.47

7. Risk, Insurance and Securities p.47

- 7.1 Indemnities p.47
- 7.2 Guarantees p.48
- 7.3 Insurance p.48
- 7.4 Insolvency p.48
- 7.5 Risk Sharing p.48

8. Contract Administration and Claims p.48

- 8.1 Personnel p.48
- 8.2 Subcontracting p.49
- 8.3 Intellectual Property p.49

9. Remedies and Damages p.49

- 9.1 Remedies p.49
- 9.2 Restricting Remedies p.49
- 9.3 Sole Remedy Clauses p.49
- 9.4 Excluded Damages p.49
- 9.5 Retention and Suspension Rights p.49
- 9.6 Termination p.50

10. Dispute Resolution p.50

- 10.1 Regular Dispute Resolution p.50
- 10.2 Alternative Dispute Resolution p.50

Dr Kamal Hossain and Associates was established in 1980 and is one of the largest law firms in Bangladesh specialising in commercial law. The firm provides a comprehensive range of legal services for both local and international clients. Its strength lies not only in the breadth of the individual expertise, but also in 44 years of institutional experience. Assisting and advising on construction contracts is one of the firm's key practice areas; other practice areas include admiralty and shipping, arbitration, banking and financial regulation, commercial and corporate law, constitutional and administrative law, employment law, energy, fiscal law, intellectual

property and telecommunications. The firm has special expertise in the infrastructure, including construction, oil, gas and power sectors. It is regularly engaged by contractors, developers and lenders in a diverse range of construction and infrastructure projects, such as airports, bridges, economic zones, expressways, power and energy projects, including coal, gas, nuclear and solar power plants, electricity transmission lines and gas pipelines, roads and highways, seaports, etc. The firm also provides representation in arbitration and litigation of construction disputes.

Authors



Sharif Bhuiyan is an advocate of the Supreme Court of Bangladesh and a founder partner and deputy head of Dr Kamal Hossain and Associates. He was co-rapporteur of the

trade law committee of the International Law Association (2009–14) and a visiting fellow at the University of Cambridge (2006). Sharif is the author of *National Law in WTO Law* (Cambridge University Press, 2007) and the co-editor of *International Law and Developing Countries* (Brill Nijhoff, 2014). He has acted as lead counsel and expert in various construction matters, including construction arbitration.



Reduanul Karim is a barrister called to the Bar of England and Wales and an advocate enrolled in the High Court Division of the Supreme Court of Bangladesh. He is a senior associate at Dr

Kamal Hossain and Associates, and practises in a broad range of commercial law areas, including admiralty and shipping, arbitration, banking and financing, construction, corporate, energy, M&A, telecommunications and securities laws. He has been counsel in various construction matters, including construction arbitration.

Dr Kamal Hossain and Associates

Metropolitan Chamber Building
2nd Floor
122-124 Motijheel CA
Dhaka-1000
Bangladesh

Tel: +8802 22338 0655
Email: khossain@citechco.net
Web: www.khossain.com

DR KAMAL HOSSAIN AND ASSOCIATES
BARRISTERS • ADVOCATES • LEGAL CONSULTANTS

1. General

1.1 Governing Law

The principal laws governing the construction market in Bangladesh include the following:

- Contract Act 1872;
- Building Construction Act 1952;
- Town Improvement Act 1953;
- Environment Conservation Act 1995;
- Building Construction Rules 1996;
- Natural Water Bodies Protection Act 2000;
- Private Residential Project Land Development Rules 2004;
- Public Procurement Act 2006;
- Public Procurement Rules 2008;
- Dhaka Metropolitan Building (Construction, Development, Preservation and Demolition) Rules 2008;
- Real Estate Development and Management Act 2010;
- Acquisition and Requisition of Immovable Property Act 2017;
- Bangladesh National Building Code 2020; and
- Environment Conservation Rules 2023.

Public Procurement Act 2006 and Public Procurement Rules 2008 govern the procurement of construction works and services using public funds by the government or its ministries, departments, statutory bodies, etc. Construction works include all works associated with the construction, reconstruction, site preparation, demolition, repair, maintenance or renovation of railways, roads, highways, buildings, infrastructure, structures or installations, or any construction work relating to excavation, installation of equipment and materials, decoration, etc. Services include procurement of goods or works relating to the operation and maintenance of construction works, and any third-party services, including security services.

In order to promote foreign investment in the infrastructure sector, the government of Bangladesh encourages implementation of large-scale public infrastructure projects, such as railways, roads, seaports, airports, expressways, flyovers, economic zones, etc, through public-private partnerships (PPP). PPP construction projects and government-to-government partnership projects are governed by, among others:

- Public Private Partnership (PPP) Act 2015;

- Policy for Implementing PPP Projects through Government to Government (G2G) Partnership 2017;
- Procurement Guidelines for PPP Projects 2018;
- Guidelines for Unsolicited Proposals 2018;
- National Priority Project Rules 2018;
- Rules for Public Private Partnership Technical Assistance Financing 2018; and
- Rules for Viability Gap Financing for Public Private Projects 2018.

1.2 Standard Contracts

The engineering, procurement and construction (EPC) model is the dominant contract model in the construction market, where the contractor performs all aspects of the work necessary to provide a completed operational construction project within the pre-agreed contract price and completion time.

A PPP contract is a long-term agreement between a government agency and a selected private partner. Prior to or after signing the PPP contract, the selected private partner incorporates a project company. Once the company is incorporated, all rights and obligations of the private partner are assigned to the project company. Under the PPP arrangement, the private partner usually assumes the responsibility of financing, constructing, and operating the PPP project. In return, they receive payments from the government and/or collect charges, levies or fees from the users of the PPP project for a certain period.

The PPP Act states that the parties may include any of the following matters in the PPP contract:

- modality of the project;
- term of the PPP contract;

- technical specification and compliance standard;
- environmental and security requirements;
- performance indicators and date of completion;
- expenditure recovery mechanism through collecting levy and strategy for its adjustment;
- construction and operation bond;
- insurance;
- acceptance test and method;
- rights and obligations of the parties and risk allocation;
- modality and amount of government financial participation;
- transfer of assets (if any) at the end of the PPP contract;
- post transfer confirmation letter and method;
- submission of report;
- supervision strategy of the contracting authority;
- ownership of assets;
- immediate steps during natural disaster;
- governing law;
- provision for arbitration;
- rights over project area; and
- security interest, etc.

There are various PPP models. Depending on the nature of the project, parties can adopt any one of the models. Some common PPP models include:

- build-operate-transfer (BOT) contract, under which the private party is responsible for designing, constructing, and operating the project during the contracted period and thereafter transferring the project back to the government agency (ie, the employer);
- build-own-operate (BOO) contract, under which the private party finances, builds, owns and operates the project and the government

agency purchases the goods and services produced by the project;

- build-operate-lease-transfer (BOLT) contract, under which a government agency gives a concession to a private entity for designing and building a project, owning it, leasing it to the government agency and subsequently transferring the ownership of the project to the government agency upon expiration of the lease;
- design-build-operate-transfer (DBOT) contract, under which the private party is responsible for designing, constructing, financing, and operating the project for the concession period and thereafter transferring the project back to the government agency; and
- operate-maintain-transfer (OMT) contract, under which the private party operates the project, ensures maintenance and provides training before handing the project to the government agency.

The use of standard contracts is not mandatory in Bangladesh. Parties may adopt any standard contract they consider appropriate for the project. Standard contracts published by the International Federation of Consulting Engineers, known as FIDIC, and the Engineering Advancement Association of Japan (ENAA) are often used for construction projects. Where parties want to deviate from the standard contracts, they agree to special conditions of contract which form part of the contract.

2. Parties

2.1 The Employer Employers

The owners of construction projects act as employers of the construction projects. The owners or employers can be individuals, private

corporations, government ministries, or any offices or directorates or departments or divisions under a ministry, or corporations or statutory bodies, local governments, or any other organisations.

Rights of employers

The rights of the employer may vary depending on the construction model (EPC, BOT, BOO, BOLT, DBOT, OMT, etc), and the specific conditions agreed by the parties. The general rights of an employer may include the following:

- obtaining various securities in the amount, manner and form specified in the contract including advance payment security and performance security for the due performance of the contract;
- right to receive indemnity, liquidated damages, impose penalties on the contractor in case of breach of contract, delay in completion of the work, non-performance of the contract by the contractor;
- withholding a partial amount from invoices for a pre-agreed defect liability period;
- ownership of intellectual property relating to all drawings, documents and other materials relating to the project;
- right to extend time for completion of the project; and
- right to terminate the contract for breach.

Obligations of employers

The obligations of the employer may vary depending on the construction model (EPC, BOT, BOO, BOLT, DBOT, OMT, etc), and the specific conditions agreed by the parties. The general obligations of an employer may include the following:

- acquiring and handing over of construction site and access thereto to the contractor, and

- providing access to all other areas required for the proper execution of the project;
- obtaining construction-related permits, approvals, and licenses from the government authorities which are necessary for the construction work;
- assisting in the import and export of contractor's equipment;
- compliance with the payment obligations;
- providing necessary personnel if required by the contract; and
- approving or appointing subcontractor(s) if so required by the contract.

Relation between the employer and the contractor, the subcontractors and the financiers

The relationship between the employer and the contractor is on a principal-to-principal basis. In respect of any subcontractor appointed by the contractor, the subcontractor is an agent of the contractor, and the contractor will be responsible for the subcontractor to the employer. There may be a separate contractual relationship between the employer, the contractor or the subcontractor on the one hand and their respective financiers on the other hand. The financiers may have supervisory rights, a security interest in the project and the right to obtain progress reports, etc.

2.2 The Contractor

Contractors

The construction contractors can be individuals, proprietorships, partnerships, companies, corporations, joint ventures or consortiums. The contractors may be either local or foreign, or a joint venture or consortium of local and foreign parties.

Rights of contractors

The rights of the contractor may vary depending on the construction model (EPC, BOT, BOO,

BOLT, DBOT, OMT, etc), and the specific conditions agreed by the parties. The general rights of a contractor may include the following:

- deploying equipment, machinery, materials and personnel on the construction site;
- receiving payment from the employer for the construction work performed;
- receiving an additional price in the event of any variation in the scope of work; and
- proposing incremental work to the employer for effective completion of the project.

Obligations of contractors

The obligations of the contractor may vary depending on the construction model (EPC, BOT, BOO, BOLT, DBOT, OMT, etc), and the specific conditions agreed by the parties. The general obligations of a contractor may include the following:

- paying earnest money at the time of tendering;
- furnishing bank guarantees and required securities in the form and manner as agreed in the contract;
- complying with the employer's requirements and specifications;
- completing and handing over the construction project within the completion time;
- removing machinery and equipment from the construction site after completion of the construction project; and
- rectifying any defects in the construction work during the defect liability period.

In respect of the relationship between the contractor, employer, subcontractor and financier, see 2.1 The Employer.

2.3 The Subcontractors

Subcontractors

Subcontractors can be individuals, proprietorships, partnerships, companies, corporations, joint ventures or consortiums. Subcontractors may be either local or foreign, or a joint venture or consortium of local and foreign parties. Typically, the scope of works of a subcontractor does not go beyond the scope of works of the main contract between the employer and the contractor.

Rights of subcontractors

Rights of the subcontractor depend on the subcontract. General rights of the subcontractor include:

- receiving payment for the services performed;
- disputing demands which are not pre-agreed; and
- seeking remedy for breach of the subcontract.

Obligations of subcontractors

Obligations of the subcontractor depend on the subcontract. General obligations of the subcontractor include:

- complying with the specifications and timelines to complete the work; and
- removal of machinery, equipment and material from the site after completion of the work.

Relation between the subcontractors, employer, contractor and financiers

Usually, the subcontractors are engaged by the contractors in compliance with the requirements set out in the contract. It is also common for the contractors to engage subcontractors nominated by the employer. No contractual relationship exists between the employer and the subcontractor. A subcontractor is an agent of the

contractor. A subcontractor does not have any right to make direct claims against the employer.

Financiers are not parties to the construction contract between the contractor and the subcontractor. Financiers can create a security interest over the construction contract or subcontract by way of assignment.

2.4 The Financiers

Financiers

Banks, financial institutions, non-banking financial institutions typically act as financiers in a construction project. These financiers can be local, foreign, or a combination of both. Both bilateral loans and syndicated loans are common. There are also construction projects that are self-financed or financed by private entities.

Rights and obligations of financiers

Generally, since financiers are not a party to the construction contract, they do not have express rights and obligations under the construction contract.

General rights of financiers in relation to employer, where the employer is the borrower, include:

- receiving updates on the progress of the project;
- securing the loan and applicable interest; a loan is generally secured by hypothecation of receivables from the construction project, mortgage of the project land, pledge of shares of the shareholders of the borrower company, corporate guarantee of the corporate shareholders of the borrower company, and creating a charge over borrower's assets and properties;
- invoking a security interest upon occurrence of an event of default or breach of terms of the loan agreement;

- step-in rights in the project, including the right to have any party novated and/or right or obligation assigned to a third party; and
- approving or consenting to any deviation in the construction project.

Financiers have a general obligation to make the funds available per the financing agreement.

Relation between the financiers, subcontractors, employer and contractor

In respect of the relationship between the financiers, subcontractors, employer and contractor, see 2.1 The Employer.

2.5 The Designer

Architecture and engineering consultant companies or firms typically act as the designer in construction projects. A designer may be either local or foreign, or a joint venture or consortium of local and foreign parties.

Under a build-only model, the designer engaged by the employer is responsible for the design of the construction works. The contractor is responsible for implementing the construction works as designed by the designer and per the contract documents. The designer bears the responsibility for any defects in the design.

Under a design-and-build model, the contractor is responsible for designing as well as implementing the construction works per the design. Under this model, the contractor can make changes to the design to make the construction works fit for their purpose.

The contractor bears the responsibility for any defects in the design and the construction works.

3. Works

3.1 Scope

The scope of work in construction contracts is determined based on the employer's requirements and nature of the project. Typically, the scope of work includes the following:

- project background;
- design and engineering requirements for the project;
- name of the code(s) to be complied with in respect of different aspects of the construction project;
- details in respect of the equipment, machines, materials, tools, civil work, spare parts, personnel, transportation of personnel, utilities, port clearance, payment of customs duty, insurance, testing, commissioning, defect liability, etc;
- details in respect of subsoil and geotechnical investigations to be carried out by the contractor;
- acquisition of the project land;
- site clearance and dismantling of structures and removal of utilities before commencement of the construction works;
- implementation schedule and the delivery modes;
- construction of temporary site offices, connected works such as construction of access roads, etc; and
- procedure for providing progress reports by the contractor.

3.2 Variations

A variation includes an addition or alteration to the original scope of works. A variation typically increases or decreases the contract price and completion time of the construction project. Construction contracts typically contain clauses for variations to the scope of work or contract

price. A variation proposal is made by way of issuance of a change order either by the employer or the contractor. Variation clauses consist of terms relating to:

- employer's right to request a variation;
- contractor's right to request a variation;
- procedure on how to proceed with and execute changes; and
- consequences of a change order in respect of, among others, additional cost, extension of completion time, suspension or termination of work, invoking dispute resolution mechanism, etc.

Both the employer and the contractor can have rights to request variations to the original scope of work in compliance with the procedure set out in the contract. Variations to the scope of work and the contract price are subject to the agreement of the parties. Certain construction contracts contain provisions allowing variation of the scope of work that does not result in an increase in the contract price beyond a pre-agreed capped price, such as 10% of the pre-agreed contract price.

3.3 Design

In respect of how the responsibilities regarding the design process are divided between the employer, the designer, the contractor and other parties, see 2.5 The Designer.

3.4 Construction

Usually, the employer does not carry out the construction works, but rather oversees and supervises the construction works and the implementation of the completion schedules by the contractor. The contractor carries out the construction works based on the design provided by the employer's designer in a build-only model contract, or designs and carries out the

construction works in a design-and-build model contract. Subcontractors carry out the specific part of construction works for which the subcontractors are engaged. Third parties may be engaged in construction works for the purpose of supplying materials or equipment or for providing other services, if so provided for in the contract.

3.5 Site

The responsibilities regarding the status of the construction site in relation to pollution, underground obstacles, geotechnical conditions, etc, are usually specified in the construction contract. However, both the employer and the contractor are responsible for complying with the laws and regulations that are applicable to a particular aspect of construction works.

Pollution

The employer and the contractor are required to comply with the applicable laws, regulations and guidelines that deal with the conservation of the environment. Construction contracts usually contain provisions making the contractor responsible for taking care of environmental and social issues during the implementation of the construction works, for complying with the employer's approved environmental and mitigation plan, and for any environmental pollution.

Underground Obstacles, Geotechnical Conditions

Construction contracts usually contain provisions requiring the contractor to inspect and examine the site and its surroundings on their own responsibility to ensure they are satisfied with the nature of the site, ground and subsoil. Construction contracts may specifically require the contractor to carry out subsoil and geotechnical investigations. In such situations, the contractor would generally bear the risk of any

underground obstacles and geotechnical conditions.

The employer may also carry out subsoil and geotechnical investigations by engaging relevant experts and provide the subsoil and geotechnical investigation reports to the tenderers as part of the tender documents. The employer may require the tenderers to rely on such subsoil and geotechnical investigation reports in submitting their bids. If during the implementation of the construction work, the subsoil and geotechnical site conditions are found to be different from those presented in the reports supplied by the employer, the employer will generally bear the risk for underground obstacles and geotechnical conditions.

Archaeological Finds

All antiquities and other objects of value found on the construction site or during excavation work are regulated by the Antiquities Act 1968.

3.6 Permits

The permits required for a construction project depend on the nature and scope of the project. Generally, the following permits are required for a construction project: land use certificate, large and specialised project permit, construction permit and occupancy certificate. No-objection certificates or clearances from various regulators are also required, such as local government, department of environment, department of fire service and civil defence, power distribution company, water development authority, water supply and sewerage authority, civil aviation authority of Bangladesh, Bangladesh telecommunication regulatory commission, etc.

Construction contracts will contain clauses imposing responsibility on the employer or the contractor to obtain permits, approvals, licenses,

clearances, no-objection certificates, etc. Typically, construction contracts impose responsibility on the employer to obtain permits, approvals, licenses, etc, which are required to be obtained in the name of the employer, for instance, construction plan approval, environmental clearance, etc. The contractor is required to obtain permits, approvals, licenses, clearances or no-objections certificates which are required to be obtained in the name of the contractor, for instance, an import permit for importing the contractor's equipment. Usually, the employer assists the contractor in obtaining necessary permits.

3.7 Maintenance

The maintenance of the construction work until completion would include maintaining the construction works, materials and equipment on the construction site, and the maintenance of a completed construction project usually includes employing qualified personnel and taking necessary measures in relation to the project site, machinery, systems and facilities, including utilities, in order to ensure the continuous operation of the construction project.

Contract terms typically dictate which party or parties are responsible for the maintenance of the construction works. Construction contracts usually contain provisions imposing responsibility on the contractor for maintaining the construction works, materials and equipment on site until the date of completion and delivery of the project to the employer. After the delivery, the employer is responsible for the operation and maintenance of the construction project. However, the contractor remains responsible for repairing, replacing or otherwise making good any defects in the construction project during the defect liability period. Usually, the contractor is not responsible for any defect caused by

improper operation and maintenance of the construction project by the employer.

It is possible for an employer to execute an operation and maintenance contract (O&M contract) with the contractor or any independent third party for the purpose of the operation and maintenance of the construction project. In such circumstances, the contractor or the third party undertakes the responsibility to operate and maintain the project per the agreed terms and conditions.

3.8 Other Functions

The necessary functions related to the construction project are usually included in the construction contract.

In addition to construction, other functions relating to the financing, operation and transfer of a construction project are common in PPP projects. In PPP projects, the project company undertakes the responsibility to construct, finance, operate and transfer the construction project after a certain time to the employer.

3.9 Tests

The contractor is responsible for carrying out all the tests relating to the delivery of a completed, operational and functional project to the employer at the contractor's cost and within the time agreed in the contract. The employer, project manager or their designated representatives are entitled to attend the tests undertaken by the contractor at the employer's cost. When the contractor is ready to carry out any test, the contractor gives advance notice to the employer or project manager. If any test fails, the contractor takes corrective measures and repeats the test by providing advance notice to the employer or project manager. Once the test is successful, the

contractor provides a test report to the employer or project manager.

3.10 Completion, Takeover and Delivery

Construction contracts contain provisions relating to the completion, takeover and delivery of the construction project. When the contractor considers that a construction project has been completed structurally and operationally, the contractor notifies the employer to inspect the project with the contractor and other relevant consultants. Following the required inspection, if the employer is satisfied that the construction project has achieved the operational completion per the contract, the employer issues a completion certificate to the contractor. If the employer notifies the contractor of any defects or deficiencies, the contractor shall remedy the defects or deficiencies and repeat the process. The completion certificate states, inter alia, the date on which the contractor has achieved the completion and the date on which the project is delivered to, and possession taken over by, the employer. Once the completion certificate is issued, the contractor may be entitled to the release of the retention payment relevant to the completion of the project.

3.11 Defects and Defects Liability Period

Usually, construction contracts contain a provision regarding defect liability, including the period of defect liability. Once the completion certificate is issued, the defect liability period starts. During the defect liability period, if any defect is found in the construction project, such as in the design, engineering, materials, and workmanship supplied by the contractor, the contractor is responsible for remedying the defect.

If the contractor fails to remedy the defect, following a notice to the contractor, the employer may proceed to remedy the defect, and the

cost incurred by the employer can be recovered from the contractor or may be deducted by the employer from any money due to the contractor or claimed under the performance security furnished by the contractor to the employer.

Construction contracts specify a notice period within which the employer is required to notify of any defect in the construction work to the contractor. If the employer fails to notify within the specified period or the defect liability period expires, the employer bears the responsibility for any cost in remedying the defect.

4. Price

4.1 Contract Price

Parties are free to adopt any method of establishing the contract price. A fixed-price method is common. Under the fixed-price method, parties agree to a fixed price for the entire construction work, and all project-related costs such as labour, materials, equipment, overhead expenses, etc, are included in the price. Construction contracts contain provisions for variation of the contract price.

Construction contracts contain the terms, procedure and schedule of payment. Payment terms in construction contracts include:

- payment of an agreed percentage of advance upon execution of the agreement;
- payment of an agreed percentage upon submission of design;
- payment of an agreed percentage upon mobilisation of contractor's equipment, personnel and construction materials at the construction site;
- payment of an agreed percentage upon satisfactory completion of specified test work; and

- payment of an agreed percentage upon successful completion and delivery of the construction work.

The terms and procedures of payment may require the contractor to provide along with the invoice a bank guarantee from a bank in Bangladesh covering the invoice amount to be valid up to the contract period. All payments are subject to deductions of applicable taxes.

Construction contracts usually contain a mechanism for interim payment to be made to the contractor for the work completed. The contractor submits a statement of works, the employer scrutinises the works, the employer agrees on the amount to be invoiced by the contractor and requests the contractor to submit the invoice, then the employer issues an interim payment certificate stating the amount due to the contractor and the time within which the payment will be made. The interim payments are made on an estimate of works done and are adjusted at the final account stage. The interim payment mechanism helps the contractor's cash flow.

4.2 Indexation

The indexation of prices is used in construction contracts. The construction contract can contain provisions on the allocation of risk for (large) price fluctuations.

4.3 Payment

Advanced payments, delayed payments and/or interim payments are generally used in construction contracts. See **4.1 Contract Price**.

Construction contracts typically contain provisions requiring the employer to pay interest in case the employer fails to make payment by the respective due date. The contracts contain the applicable interest rate.

4.4 Invoicing

Construction contracts usually contain the manner in which the contractors are to issue invoices to the employers and the timelines within which the employers are to make the payments. One common method of invoicing is based on the interim payment certificate issued by the employer. Regarding how invoices are issued by the contractor in relation to interim payments, see 4.1 Contract Price.

5. Time

5.1 Planning and Programme

The contractor, within a date specified in the contract, submits to the project manager appointed by the employer a detailed programme of performance of the contract showing the sequence in which it proposes to provide design of the construction work, mobilise the personnel and equipment, supply the material to be supplied by the contractor, complete the construction work, and the date by which the employer is required to fulfil its obligations under the contract. The programme must be complied with on the basis of the time schedules and any other dates and periods specified in the contract. The contractor monitors the progress of all the activities and submits progress reports to the project manager. In case the progress falls behind the programme, the employer may request the contractor to submit a revised programme and take necessary measures, such as increasing manpower, to ensure that the works are completed within the completion time.

5.2 Delays

In the event of delay in completing the work, the contractor is required to notify the employer in writing as soon as reasonably practicable and seek an extension of time providing particulars

of the events or circumstances justifying the extension of time. After receipt of the notice by the employer, the parties discuss the situation and take necessary steps including mitigating steps. If delay is justified under the contract, for instance, the delay was caused by a force majeure event or unforeseen circumstance or due to any change in the scope of the work by the employer, the contractor usually gets an extension of time and the extra cost attributable to the delay. If the delay is due to the contractor, the employer is entitled to claim liquidated damages per the contract.

5.3 Remedies in the Event of Delays

In the event of delay, the employer can:

- claim liquidated damages, which is a pre-agreed amount of damages required to be paid by the contractor to the employer for the delay; the contract contains the rate of and the maximum amount of money that can be claimed as liquidated damages;
- terminate the contract and claim compensation for any loss or damage caused by the breach of contract by the contractor;
- engage a new contractor to complete the work and seek indemnification from the defaulting contractor; and
- encash bank guarantees furnished by the contractor.

5.4 Extension of Time

The grounds based on which the employer provides time extensions are usually contained in the contract. They would include any change in the scope of work by the employer, the occurrence of a force majeure event, unforeseen circumstances, a change in the law and regulation impacting the performance of the contract, and any default or breach of contract by the employer.

The contractor usually submits a notice of claim for an extension of time within a prescribed time setting out the particulars or events justifying the extension of time and providing supporting documents, such as progress reports, delay analysis reports and any other information or documents to substantiate the extension request. If the contractor fails to seek an extension of time in compliance with the pre-conditions provided in the contract, there is a risk that the employer may refuse the time extension request.

If the employer refuses to extend the time on any grounds, which the contractor considers unjustified, the contractor has the right to invoke the dispute resolution mechanism, such as arbitration, provided in the contract.

5.5 Force Majeure

Construction contracts usually define the expression “force majeure” as events and circumstances beyond the control of the parties, and provide a list of force majeure events which include war, flood, riots, fire, cyclone, earthquake, terrorist attack, etc. It is possible to contractually limit or exclude certain circumstances from being qualified as force majeure. The consequences of a force majeure event are provided for in the contract, which include suspension of work during the continuance of the force majeure event, extension of completion time, and termination of the contract if the force majeure event subsists beyond a time specified in the contract.

5.6 Unforeseen Circumstances

Unforeseen circumstances can be governed by law, or contractually agreed upon by the parties. Section 56 of the Contract Act 1872 states that a contract the performance of which becomes impossible or unlawful is void.

Construction contracts usually contain a list of circumstances which would qualify as unforeseen circumstances. Such circumstances can include any physical condition or artificial obstruction or sub-surface ground condition, that could not have been foreseen prior to the date of the execution of the contract. Construction contracts contain steps to be taken by the contractor following the discovery of an unforeseen site condition. Typically, the contractor is required to notify the employer promptly of any unforeseen site condition explaining the nature of the unforeseen condition, additional work that would be required, including the steps the contractor proposes to take to overcome the same, the extent of anticipated delay, additional cost and expense that the contractor is likely to incur, etc. After receiving such a notice, the employer discusses it with the contractor and decides on the actions to be taken. Following such consultation, if the employer instructs the contractor to take any action, the employer pays the additional cost and expenses and extends the completion time.

Depending on the terms of the contract in relation to the contractor's obligation to carry out investigations of the site condition prior to the execution of the contract, the employer may dispute the contractor's claim that a particular site condition is an unforeseen site condition and seek to impose the liability relating to such condition on the contractor. In this case, the employer could argue that the contractor could have foreseen the site condition had it properly performed its obligations relating to the site investigation. If the contractor does not agree with the employer, the dispute resolution clause can be invoked.

5.7 Disruption

Disruption is not an express legal ground for an extension of time. If the disruption is such that it makes the performance of the contract impossible, Section 56 of the Contract Act 1872 may be invoked.

Disruption in relation to the supply of materials, equipment or personnel may be dealt with and agreed to be a ground for extension of time in the contract. In the absence of a contractual provision on disruption, depending on the wording of the force majeure clause, disruption may be interpreted as a force majeure event. The party relying on the disruption has to establish the nexus between the disruption and the impact of disruption on the performance of the construction work. Whether the relevant party has taken any reasonable measure to mitigate the impact of disruption is one of the relevant factors.

6. Liability

6.1 Exclusion of Liability

Some liabilities which cannot be contractually excluded include liabilities arising from fraud or wilful misconduct, personal injury or death caused by the negligence or breach of duty, breach of statutory obligations relating to safety regulations or environmental laws.

6.2 Wilful Misconduct and Gross Negligence

The concepts of wilful misconduct and gross negligence exist in Bangladesh. The principle of duty care under the law of tort governs negligence.

Construction contracts usually contain provisions making the contractor liable for loss or

damage caused by gross negligence, fraud, criminal or wilful misconduct of the contractor.

6.3 Limitation of Liability

It is possible for the parties to contractually limit their liability. Usually, the liability of the contractor is limited. Limitation of liability clauses generally state that the contractor shall not be liable to the employer whether in contract or tort or otherwise for any indirect or consequential loss or damage or loss of profits, and provide an upper limit of the aggregate liability of the contractor to the employer. Limitation of liability clauses state that such limitation of liability does not apply to the liquidated damages or to the cost of repairing or replacing defective equipment. Construction contracts contain an upper limit which can be claimed as liquidated damage, for instance 10% of the contract price.

Limitation of liability of the parties in respect of compensation for breach of contract is recognised in Sections 73 and 74 of the Contract Act 1872.

7. Risk, Insurance and Securities

7.1 Indemnities

Indemnity clauses are common in almost all construction contracts. The extent of indemnification varies depending on the terms of the contract. Typically, the employer seeks to be indemnified by the contractor in relation to:

- suits, actions or administrative proceedings, claims, demands, losses, damages, costs and expenses including attorney's fees and expenses arising from the acts of the contractor or its subcontractor or their employees, officers or agent for which the employer may become liable;

- death or personal injury or loss or damage to any property caused or contributed by the contractor or its subcontractor or their employees, officers or agents; and
- claims by workmen employed by the contractor.

The contractor seeks to be indemnified by the employer in respect of any liability for loss or damage caused by fire, explosion or any other perils which are not caused by any act or failure of the contractor.

7.2 Guarantees

Construction contracts contain provisions requiring the contractors to furnish various bank guarantees for the amounts specified in the contracts in favour of the employers. A bank guarantee is considered as a separate contract between the relevant bank and the employer, and independent from the construction contract. The bank guarantees include:

- performance bank guarantee for the due performance of the contract;
- advance payment guarantee to secure the advance payment made by the employer;
- payment bank guarantees to cover various payments made in relation to mobilisation of equipment, supply of materials, etc;
- corporate bank guarantee provided by the contractor or its shareholders; and
- retention bank guarantee to cover the defect liability period.

Construction contracts set out the dates for release of the bank guarantees.

7.3 Insurance

The insurances that are typically taken out in construction contracts include:

- cargo insurance during transport policy covering loss or damage occurring while in transit from the destination to the construction site;
- all risk insurance policy covering physical loss or damage to the construction work including all materials and goods on site occurring prior to completion of the work and during the defect liability period;
- third-party liability insurance policy covering vehicles used by the contractor in connection with the execution of the contract;
- workers' compensation insurance policy covering any death or personal injury of the workmen appointed by the contractor; and
- employer's liability insurance policy covering the liability towards the employees engaged in the construction work.

7.4 Insolvency

Construction contracts usually contain provisions entitling a party to terminate the contract upon insolvency of the other party. Usually, these provisions are the same for both the employer and the contractor.

7.5 Risk Sharing

Since the contractor bears the entire responsibility to perform the contract, the risks associated with the construction contract are borne by the contractor. However, the employer bears the risk in relation to any defect in the title of the project land or obtaining necessary government authorisations regarding the construction of the project. These risks are typically not shared.

8. Contract Administration and Claims

8.1 Personnel

Construction contracts contain provisions regarding the appointment of personnel by the

employer and the contractor, the total number of personnel to be appointed, the designation and responsibilities of the personnel, reporting requirements, etc. Usually, the employer appoints the project manager or project director and engages personnel to supervise and certify the construction works and tests. The contractor appoints the contractor's representative, construction manager and other personnel to complete the construction works.

8.2 Subcontracting

It is common for construction contracts to contain provisions allowing the contractor to appoint subcontractors to carry out works or services specified in the contract. Construction contracts may contain a list of pre-agreed subcontractors, and in the absence of a pre-agreed list, allow the contractor to propose names of the subcontractors to be approved by the employer.

8.3 Intellectual Property

Construction contracts usually contain a clause conferring on the employer intellectual property rights created in relation to the construction work.

9. Remedies and Damages

9.1 Remedies

The Contract Act 1872 entitles the non-defaulting party to claim from the defaulting party compensation for any loss or damage caused by the breach of contract which naturally arises from the breach. Where a sum is named in the contract as the amount to be paid in the case of breach of contract, for instance, liquidated damages, the non-defaulting party can recover a reasonable compensation not exceeding the amount so named. A party may also claim other remedies, such as indemnity, under the contract.

In case of breach of contract, the non-defaulting party may terminate the contract for breach and claim compensation or may continue with the contract reserving its right to claim compensation under the law and the contract.

9.2 Restricting Remedies

It is common practice in Bangladesh to contractually limit the remedies available to a party. For instance, in case of total liability and liquidated damages, the parties set out in the contract the agreed upper limit of the total liability and liquidated damages. However, there are certain exclusions in respect of which limitation of liability is not applicable, such as fraud, negligence and wilful misconduct.

9.3 Sole Remedy Clauses

Sole remedy clauses are not typically used in Bangladesh.

9.4 Excluded Damages

Section 73 of the Contract Act 1872 excludes certain types of damages, such as damages for remote and indirect loss or damage.

It is common that parties contractually exclude or limit their liability in respect of certain damages, for instance, indirect or consequential damages, loss of profit, loss of use, etc.

9.5 Retention and Suspension Rights

Retention and suspension rights are contractually included in construction contracts in Bangladesh. A suspension clause allows the employer to request the contractor by notice to suspend performance of any or all of its obligations. In the notice, the employer states the reason for suspension. A suspension clause also entitles the contractor to suspend performance of the contract on the grounds provided for in the contract, which typically include delay in payment

by the employer, failure to approve any invoice or supporting document without just cause, and occurrence of any force majeure event.

9.6 Termination

Construction contracts provide for circumstances for termination. The circumstances usually include termination for employer's convenience, termination for breach of contract by either party, termination for insolvency of either party, termination for force majeure, etc. The termination clause sets out the consequences of termination and consequences depend on the circumstance of the termination. General consequences include:

- the contractor ceases all further works, terminates subcontracts, removes contractor's equipment and personnel from the site, delivers the completed part of the work;
- the employer pays the contract price attributable to the completed part of the work, costs reasonably incurred in removing the equipment from the site and the amount payable by the contractor to any subcontractor; and
- the employer may enter the site, expel the contractor if the contractor does not willingly leave the site, complete the outstanding work by engaging a third party and recover any excess sum from the defaulting contractor.

Following termination of the contract, either party may invoke the dispute resolution mechanism, such as arbitration, contained in the contract if it considers that the termination is unlawful.

10. Dispute Resolution

10.1 Regular Dispute Resolution

Construction contracts usually contain a dispute resolution clause providing for the agreed forum for the resolution of disputes. In the absence of

a dispute resolution clause, Bangladesh courts will have jurisdiction over the disputes arising out of the contract. The Bangladesh court within the local limit of whose jurisdiction the office of the defaulting party is situated, or the cause of action wholly or partly arises, or where the construction project is situated, will have jurisdiction.

By a dispute resolution clause, the parties can confer on Bangladesh or foreign courts or on an arbitration tribunal exclusive or non-exclusive jurisdiction over their disputes.

Parties' choice of a foreign court would not oust Bangladesh courts' jurisdiction automatically, if the cause of action wholly or partly arises in Bangladesh. If a party files proceedings in Bangladesh disregarding the jurisdiction clause in favour of a foreign court, and if any anti-suit injunction is issued by the foreign court, the Bangladesh courts would have discretion to either give effect to such injunction and decline jurisdiction in favour of the foreign court, or proceed with the matter despite the anti-suit injunction. Thus, jurisdiction clauses in favour of foreign courts are not automatically enforceable.

If parties include an arbitration clause in the contract conferring jurisdiction on an arbitration tribunal, the jurisdiction of the Bangladesh courts can be excluded. An arbitration clause usually provides for the arbitration rules applicable to the arbitration, the seat of the arbitration, the composition of the arbitration tribunal, the language applicable to the arbitration, etc.

10.2 Alternative Dispute Resolution

Arbitration is the most common alternative mechanism of dispute resolution in Bangladesh. Arbitration is regulated by the Arbitration Act 2001.

BRAZIL

Law and Practice

Contributed by:

Thiago Fernandes Moreira, Alexandre Arlota,
Natália Carvalho Mauad and Rafael Kasarz

Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados



Contents

1. General p.55

- 1.1 Governing Law p.55
- 1.2 Standard Contracts p.55

2. Parties p.55

- 2.1 The Employer p.55
- 2.2 The Contractor p.56
- 2.3 The Subcontractors p.57
- 2.4 The Financiers p.57
- 2.5 The Designer p.57

3. Works p.58

- 3.1 Scope p.58
- 3.2 Variations p.58
- 3.3 Design p.59
- 3.4 Construction p.59
- 3.5 Site p.60
- 3.6 Permits p.60
- 3.7 Maintenance p.61
- 3.8 Other Functions p.61
- 3.9 Tests p.61
- 3.10 Completion, Takeover and Delivery p.61
- 3.11 Defects and Defects Liability Period p.62

4. Price p.62

- 4.1 Contract Price p.62
- 4.2 Indexation p.63
- 4.3 Payment p.63
- 4.4 Invoicing p.64

5. Time p.64

- 5.1 Planning and Programme p.64
- 5.2 Delays p.65
- 5.3 Remedies in the Event of Delays p.66
- 5.4 Extension of Time p.66
- 5.5 Force Majeure p.67
- 5.6 Unforeseen Circumstances p.67
- 5.7 Disruption p.68

6. Liability p.68

- 6.1 Exclusion of Liability p.68
- 6.2 Wilful Misconduct and Gross Negligence p.68
- 6.3 Limitation of Liability p.68

7. Risk, Insurance and Securities p.68

- 7.1 Indemnities p.68
- 7.2 Guarantees p.69
- 7.3 Insurance p.69
- 7.4 Insolvency p.70
- 7.5 Risk Sharing p.71

8. Contract Administration and Claims p.71

- 8.1 Personnel p.71
- 8.2 Subcontracting p.72
- 8.3 Intellectual Property p.72

9. Remedies and Damages p.72

- 9.1 Remedies p.72
- 9.2 Restricting Remedies p.73
- 9.3 Sole Remedy Clauses p.73
- 9.4 Excluded Damages p.73
- 9.5 Retention and Suspension Rights p.73
- 9.6 Termination p.74

10. Dispute Resolution p.74

- 10.1 Regular Dispute Resolution p.74
- 10.2 Alternative Dispute Resolution p.75

Contributed by: Thiago Fernandes Moreira, Alexandre Arlota, Natália Carvalho Mauad and Rafael Kasiaz, Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados

Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados is a high-performance, full-service Brazilian law firm and an established market reference in over 40 areas of law. Renowned for its excellence, it is a leading firm in all fields. It serves as a strategic partner, anticipating trends and providing innovative solutions to complex problems. It believes in practising law dynamically to keep up with the fast pace of global changes. One of its main purposes is to generate positive impacts on society through its legal

work. Mattos Filho knows how fundamental its professionals are to its business, and as such, professional development is a leading priority. The firm supports democratising access to justice and guaranteeing fundamental rights. As a pioneer of pro bono services in Brazil, Mattos Filho provides free legal advice to organisations with financial constraints, as well as economically and socially vulnerable individuals. This is its way of giving back to society. This is its way of driving transformation.

Authors



Thiago Fernandes Moreira is a partner specialised in construction and complex contracts, including onshore, offshore and equipment supply contracts, take-or-pay contracts,

as well as project development. His experience includes advice to owners and contractors on preparation, negotiation, pre-litigation and arbitration involving complex contracts. He has experience in the energy, ports, airports, subways, railways, ship-building, and oil and gas sectors. Thiago has worked for the Inter-American Investment Corporation in Washington, DC and acts as member of the Society of Construction Law in London and Co-Vice Chair of the Project Execution Subcommittee of the International Construction Projects Committee of the International Bar Association.



Alexandre Arlota is a partner specialised in project development for all infrastructure sectors, including energy, oil and gas, shipping, logistics (airports, highways,

ports, railways, urban mobility), sanitation and mining. Alexandre advises clients throughout all stages of the project cycle, negotiating engineering and construction contracts, as well as strategically preventing and preparing disputes. Alexandre holds a PhD and Master's in International Law, collaborating frequently with international publications. He has authored numerous books and papers that have been cited by Brazilian courts. A former associate at Milbank in London, Alexandre participated in several prominent infrastructure transactions in emerging markets, including Latin-America, Africa and the Middle East.

Contributed by: Thiago Fernandes Moreira, Alexandre Arlota, Natália Carvalho Mauad and Rafael Kasiarz, Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados



Natália Carvalho Mauad is a partner focusing on project development especially related to the infrastructure sector. Her experience includes drafting, review and negotiation of all

types of construction contracts, as well as pre-litigation management of construction risks and claims. Natália also advises national and foreign companies on the drafting, review and negotiation of a wide range of contracts, including commercial contracts (eg, distribution agreements, commercial representation agreements, supply agreements, and services agreements). She previously worked as an international associate at Herbert Smith Freehills in New York.



Rafael Kasiarz is an associate focusing on project development and related transactions for all infrastructure sectors, including energy, oil and gas, transportation, and steel. His

experience includes analysis, drafting and negotiation of complex contracts (eg, EPC, EPCM, O&M, DBOT, asset management agreements, BOP, transitional services agreements, development services agreements and charter agreements). Rafael also has experience in analysis, drafting and negotiation of commercial contracts (eg, distribution agreements, sale and purchase contracts, supply agreements, services agreements, agency agreements, research and development agreements and memoranda of understandings).

Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados

Alameda Joaquim Eugênio de Lima, 447
São Paulo
Brazil

Tel: +55 21 3231 8200
+55 11 3147 7600

Email: mattosfilho@mattosfilho.com.br

Web: www.mattosfilho.com.br/en/

The logo for Mattos Filho, featuring the name "MATTOS FILHO" in white capital letters on an orange rectangular background. The letter "A" in "MATTOS" is stylized with a blue triangle pointing upwards.

MATTOS FILHO

Contributed by: Thiago Fernandes Moreira, Alexandre Arlota, Natália Carvalho Mauad and Rafael Kasiaz, Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados

1. General

1.1 Governing Law

Even though the legislation applicable to each project may vary depending on the industry sector, as well as per the state and municipal regulations applicable to the project's location, the main laws governing project development and construction at a federal level in Brazil include the following.

- Federal Law No 10,406/2002 (Brazilian Civil Code), which establishes the general rules regarding private, commercial and business relationships, and the key provisions governing the execution and performance of contracts in Brazil.
- Federal Law No 14,133/2021 (Brazilian New Public Procurement Law), which establishes the general rules on tenders and procurement regarding works, services, purchases, divestiture and leases by the public administration in Brazil.
- Consolidation of Labour Laws (Decree-Law No 5,452/1943), which establishes the general rules regarding labour relations in Brazil.
- Complementary Law No 140/2011, which establishes general rules regarding environmental licensing proceedings.
- Federal Decree No 8,437/2015, which further details Complementary Law No 140/2011 with regards to federal environmental licensing proceedings.
- Brazilian National Tax Code (Federal Law No 5,172/1966), which establishes general rules regarding taxation in Brazil.

1.2 Standard Contracts

Most of the construction contracts entered into in Brazil are tailor-made contracts, not prepared around standard forms (eg, FIDIC, NEC, JCT). In recent years, however, due to the increased

influx of international players in the Brazilian project development and construction markets, the use of standard forms has gained some popularity.

In this sense, when parties opt to use standard forms to enter their contracts, there is a noticeable preference for FIDIC contracts in comparison to other standard forms, with the FIDIC Rainbow Suite standard forms being the most used, especially the Silver Book, considering the overall preference of the sponsors and lenders offering project financing for procurement through engineering, procurement and construction (EPC) in a full-turnkey arrangement.

2. Parties

2.1 The Employer

Employers in construction projects in Brazil include public entities and private companies, such as national and foreign project development companies and investment funds.

Employers' rights under construction contracts entered into in Brazil usually include provisions related to:

- having the works performed by the contractor in accordance with the performance requirements and deadlines provided in the contract;
- monitoring and inspecting the works performed by the contractor or its subcontractors;
- approving key subcontractors (eg, above a certain threshold or for a list of critical activities);
- requiring the contractor to remedy any defects identified in the works during construction or under the contractor's defect liability period; and

Contributed by: Thiago Fernandes Moreira, Alexandre Arlota, Natália Carvalho Mauad and Rafael Kasiaz, Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados

- remedies for breach by the contractor of its obligations under the contract, such as delay liquidated damages, performance liquidated damages and, in case of a material default, the employer's right to terminate the contract due to the contractor's default.

Construction contracts usually define as obligations to be carried out by the employer:

- providing the contractor with continuous access to the site, as necessary for performance of the works in accordance with the deadlines defined in the contract;
- obtaining and maintaining the licences under the employer's responsibility as per the contract;
- co-operating with the contractor for obtaining and maintenance of the licences under contractor's responsibility;
- paying the contract price in accordance with the payment schedule and invoicing provisions of the contract; and
- bearing eventual increase in the contract price and/or the extension of the completion date upon the occurrence of certain events defined in the contract (eg, scope variations, force majeure, change in law).

2.2 The Contractor

Generally, considering the overall preference of the Brazilian construction market for EPC arrangements, contractors are usually private companies with sufficient expertise and resources to carry out complex construction projects.

Contractors' rights under construction contracts generally include:

- the right to receive the contract price in accordance with the payment and invoicing provisions of the contract;

- remedies for breach by the employer of its obligations under the contract, such as late payment penalties, suspension of the performance of the works such as in the case of the employer's failure to pay for undisputed amounts for a prolonged period, and the right to terminate the contract due to the employer's material default; and
- the right to request the increase of the contract price and/or the extension of the completion deadlines upon the occurrence of certain events defined in the contract (eg, scope variations, force majeure, change in law).

Construction contracts entered into in Brazil usually provide as the contractor's obligations:

- performance of the works in accordance with the requirements and deadlines provided in the contract;
- correction of defects identified in the works during construction or the contractor's defect liability period;
- obtainment and maintenance of the licences under the contractor's responsibility as per the contract; and
- co-operation with the contractor for obtaining and maintenance of licences under the contractor's responsibility.

Furthermore, in most construction contracts entered into in Brazil, the contractor is entirely liable to the employer for any work performed by its subcontractors since there is no direct/implied contractual relationship between the employer and subcontractors. Most contracts contain provisions expressly reinforcing the exclusive liability of the contractor in this sense, regardless of the relevant subcontracting being carried on with the prior and written consent of the employer or in accordance with a list of

Contributed by: Thiago Fernandes Moreira, Alexandre Arlota, Natália Carvalho Mauad and Rafael Kasiaz, Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados

pre-approved subcontractors established in the contract.

2.3 The Subcontractors

Subcontractors in construction projects in Brazil include a large array of private companies from different industry sectors, ranging from suppliers of materials (eg, cement, steel, asphalt) to suppliers of main equipment (eg, trackers, inverters, photovoltaic modules, cables) and providers of specialised services (eg, technical advisory, environmental management, vegetation removal, design of special works).

The relationship between the contractor and its subcontractors is governed through contracts entered into directly by such parties, which usually assign to the contractor the rights and obligations similar to those that would be assigned to the employer in respect of the relevant contractor under a regular construction contract. Furthermore, construction contracts may require the contractor to include certain provisions in the contracts entered into between the contractor and its subcontractors, including the employer's right to step-in such subcontracts in case of termination of the construction contract.

In certain cases, to reduce the project's cost burden (especially regarding the payment of taxes) it is usual to provide for the direct invoicing by subcontractors supplying goods and materials (and not services) to the employer. In such cases, except for the employer's obligation to make payments to the relevant subcontractors (which shall be discounted from the contract price to be paid to the contractor under the construction contract), the contractor shall remain fully and exclusively liable for any works performed by the relevant subcontractors.

2.4 The Financiers

Third-party financiers in Brazil include private banks, both national and foreign, export credit agencies and, especially, local public banks, such as BNB (Bank of the Northeast of Brazil) and, mainly, BNDES (Brazilian National Economic and Social Development Bank).

Even though the relationship between financiers and the employer is usually governed by a specific loan agreement, construction contracts may include some provisions to improve the overall financiability of the project, such as:

- the right of the financing parties to step-in the contract, in substitution for the termination of the contract, in case a material event of default by the employer arises;
- the right of the employer to transfer, assign, encumber and/or pledge its rights and obligations under the contract in favour of the financing parties; and
- the obligation of the contractor to observe requirements and guidelines of the financing parties to enable the financing of the project.

Furthermore, considering that construction contracts are typically material contracts from a financial perspective, it is usual for the loan agreements entered into by the employer and financing parties to provide that any amendments or waivers under the relevant construction contracts shall be previously approved by the financing parties.

2.5 The Designer

Designers are companies engaged to provide specialised engineering and architectural services for a range of projects. It is important to highlight that, considering the overall preference of the Brazilian construction market for EPC arrangements, designers are generally subcon-

Contributed by: Thiago Fernandes Moreira, Alexandre Arlota, Natália Carvalho Mauad and Rafael Kasiaz, Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados

tracted by contractors under the EPC contracts and thus do not have any direct or indirect relationship with the employer.

The basic design, which is typically provided by the owner to the contractor, is closer to a conceptual design, with very little detailing, and most commonly prepared in-house (please refer to 3.3 Design).

A designer's rights under its specific contracts generally include:

- the right to receive the contract price in accordance with the payment and invoicing provisions of the contract; and
- the right to request the increase of the contract price for scope variations requested by the employer and/or the contractor, under a subcontract.

A designer's obligations under its specific contracts usually include:

- performance of the works in accordance with the requirements and deadlines provided in the contract and the scope requested by the employer and/or the contractor, under a subcontract; and
- the obligation to take full technical responsibility for the design and structural implications of such design.

3. Works

3.1 Scope

In most construction contracts, the employer is the party responsible for determining the scope of the works. Such scope is usually defined by means of technical specifications and other requirements attached to the contract and,

in some cases, also by means of the basic design of the works, in case it is provided by the employer. Depending on the technical expertise of the employer and the complexity of the project, such definition of scope may be carried on by the employer in-house or may require the engagement of third-party design professionals and technical advisers.

Furthermore, it is common for construction contracts, especially EPC agreements, to provide for fit-for-purpose obligations, in a manner that the contractor is responsible for performing all the supply, activities and services – even if not directly mentioned in the agreement, in technical specifications and requirements attached thereto – that are necessary for completion of the works in a manner that allows the full, safe and reliable operation by the employer. The compliance with such provisions and the contractor's duty to abide by implied (not written) undertakings typically result in a scope of works larger than that expressly provided in the contract.

Finally, although more unusual in Brazil, in cases when there is the early engagement of the contractor, the determination of the scope of the works may be carried on jointly by the employer and contractor.

3.2 Variations

In case a contract does not contain specific procedures regarding variations, the provisions of the Brazilian Civil Code shall apply. In this sense, the employer may request variations provided that: (i) it reimburses the contractor for any additional costs arising from such variations; and (ii) the contractor may refuse to implement variations which are considered disproportional to the design of the works previously approved by the parties. Furthermore, it is worth noting that, as per the Brazilian Civil Code, if the contract

Contributed by: Thiago Fernandes Moreira, Alexandre Arlota, Natália Carvalho Mauad and Rafael Kasiaz, Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados

does not provide otherwise, the employer shall be obliged to remunerate the contractor for any additional scope performed by the contractor, if the employer, constantly supervising the works, could not have been unaware of the performance of such scope and never expressed to the contractor its objection in this regard.

However, in most construction contracts for complex projects, the parties do detail how variations should be dealt with, so as to minimise – or even preclude in its entirety – the application of the Brazilian Civil Code. Among other provisions, construction contracts often set forth the employer's right to require a variation, without the contractor's prior consent regarding price and impacts to the project schedule, provided that such variation is technically feasible and accounts up to a certain percentage of the contract price. In this regard, construction contracts may provide mechanisms for preliminary definition of the variation's impact in the contract price and/or the project schedule until the dispute is finally settled.

3.3 Design

Most construction contracts in Brazil allocate the responsibility for the works' design in accordance with the following methods:

- the contractor shall be exclusively responsible for the design of the works, with due observance of the technical specifications and requirements provided in the contract. In this case, the contractor shall be the single point of liability before the employer for any flaw or defect in the design of the works; or
- the employer shall be responsible for the basic design of the works, as prepared in-house by the contractor and/or with the engagement of third-party specialised professionals. The contractor shall then be respon-

sible for detailing the basic design provided by employer. In this case, contracts usually provide one of the following two different scenarios, the first being more common than the latter:

- (a) the contractor must review the employer's basic design of the works prior to the preparation of the detailed design, being, therefore, fully responsible for any flaw or defect in the design of the works, regardless if it arose from a flaw or defect in the basic design prepared by the employer; or
- (b) the employer shall be responsible for the correctness of the basic design it provided to contractor, and, therefore, the contractor shall not be responsible for a flaw or defect in the detailed design of the works if it resulted directly from a flaw or defect in the basic design prepared by the employer.

3.4 Construction

Usually, the employer is not responsible for performing any construction services necessary for completion of the works.

In most cases, the employer is also not responsible for supplying any goods necessary for performance of the works, but there are specific cases in which it makes sense for the employer, due to commercial reasons, to provide the main equipment, or part of it, that shall be installed and incorporated into the works by the contractor. In case of the latter, although is not common for the contractor to be liable for delays in the delivery of such goods, the contractor is responsible for duly inspecting them upon receipt, subject to assuming liability for the defects (except for defects not identifiable by means of the inspection procedures agreed by the parties) that are not notified to the employer under a timeframe

Contributed by: Thiago Fernandes Moreira, Alexandre Arlota, Natália Carvalho Mauad and Rafael Kasiaz, Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados

defined in the contract, counted from the delivery of the respective goods.

With exception to the above, generally, the contractor is entirely responsible for the performance of all obligations, supplies and services necessary for completion of the works, being fully liable to the employer in this regard, regardless of part of them being performed by subcontractors, since there is no direct contractual relationship between the employer and subcontractors and most contracts contain provisions expressly reinforcing the exclusive liability of the contractor in this regard (please refer to **2.3 The Subcontractors**).

3.5 Site

Responsibility and risk for pre-existing site conditions (eg, archaeological finds, underground obstacles, geotechnical conditions) is usually agreed in contract by the parties and, therefore, the risks assumed by each party may vary depending on the risk profile of the parties to a specific contract.

Nonetheless, in general, risks related to real estate, archaeological findings and pre-existing hazardous material are assumed by the employer.

With regards to other risks, usually the employer provides the contractor with a limited set of information regarding the site and its conditions; such information being merely informative (ie, not implying any liability of the employer before the contractor with regards to its correctness and accuracy), the contractor being responsible to confirm and complement such information by means of its own data, research, testing and analysis. Other information provided is definitive and the employer is liable to the contractor for its correctness and accuracy, being obliged to compensate the contractor for any additional

costs and/or extension of time resulting from the assessment and the extent to which the real site conditions differ from those informed by the employer.

3.6 Permits

The specific licences and permits to be obtained with regards to construction and operation may vary depending on the industry sector and specific conditions of each project.

Nonetheless, the construction of a project would generally require, at a minimum:

- preliminary and installation environmental licences;
- reports of technical responsibility for engineering and architecture services;
- permits related to specific activities to be carried on by the contractor (eg, permits regarding the use of explosives or hazardous materials; temporary or definitive disposal of waste; importation, transportation, handling and storage of certain goods);
- registry of the completion of the works in the certificate of title of the project's site;
- inspection certificate and other permits issued by the local fire department; and
- occupancy permit and business licence (*alvará de funcionamento*).

Although Brazilian law usually defines the party on behalf of which certain permits shall be issued, the responsibility for obtainment and maintenance of permits may be agreed in contract by the parties, provided that each party shall co-operate for the obtainment and maintenance of the permits which are the other party's responsibility, especially in case a permit shall be issued on behalf of the party which is not contractually responsible for its obtainment.

Contributed by: Thiago Fernandes Moreira, Alexandre Arlota, Natália Carvalho Mauad and Rafael Kasiaz, Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados

In this sense, contracts tend to provide that: (i) the employer shall be responsible for the obtainment of real estate easements, as well as the environmental and regulatory permits related to the permanent settlement of the project; and (ii) the contractor shall be responsible for the obtainment of all other permits necessary for performance of the works which are not the employer's responsibility, as per the aforementioned criteria.

3.7 Maintenance

During the construction process, the contractor shall be responsible for preserving and maintaining the works, and bearing the risk of loss regarding the works. Upon completion/taking-over, however, the risk of loss regarding the works is generally transferred to the employer.

Maintenance of the works is usually addressed in specific contracts to be entered into either by the employer and contractor or by the employer and third parties, once the construction is completed and the project enters into commercial operation. In some industries, however, such as energy generation, it is usual for construction contracts to be negotiated jointly with long-term maintenance contracts for highly technological components, such as service and availability agreements (SAAs) for wind turbine generators; and long-term service agreements (LTSAs) for steam turbines, in either case due to the fact that no third party retains proprietary information nor the design and manufacturing capability of the related parts and spares.

3.8 Other Functions

It is not common for the performance of other functions related to the construction process (eg, operation, finance, transfer) to be provided under the construction contract entered into by the employer and contractor. Such functions are

usually either performed by the employer itself or have their performance governed by means of specific contracts entered into between the employer and third parties.

3.9 Tests

The specific tests for completion of the works may vary depending on the scope and specific conditions of the works. Nonetheless, such tests usually include the inspection, cold commissioning and hot commissioning of the works.

Generally, the contractor is responsible for performing the tests for completion of the works, which may be inspected by the employer, third parties nominated by the employer and/or financing parties. With regards to some specific tests, such as the hot commissioning of the works, it could also be arranged that the employer shall provide the manpower necessary for execution of such tests, provided that the contractor shall provide such manpower with the relevant training and shall supervise and remain responsible for the outcome of those tests.

Finally, in case interfaces with third parties are required for performance of the completion tests, the parties may agree in contract which party shall be responsible for co-ordinating such interface and shall bear the related risks, as well as the consequences in case the performance of such tests for completion is impaired or delayed as a result of the lack of a satisfactory interface.

3.10 Completion, Takeover and Delivery

The processes of completion, takeover and delivery of the works are usually agreed in contract. In this sense, most construction contracts clearly define the conditions that shall be fulfilled and the procedures that shall be observed for the substantial and final completion of the works to be considered achieved.

Contributed by: Thiago Fernandes Moreira, Alexandre Arlota, Natália Carvalho Mauad and Rafael Kasiaz, Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados

Generally, the conditions for substantial completion of the works include completion of the entirety of the works, except for minor items that can be addressed by means of punch-lists, and the approval of the works in the tests to be conducted for completion works, as mentioned above. Generally, upon substantial completion, the risk of loss regarding the works is transferred from the contractor to the employer, the defect liability period (whether legal or contractual) begins, and the employer is allowed to commence the operation of the works.

For final completion of the works, requirements usually include the full completion of the works (including the items indicated in punch-lists) and the end of the contractual defect liability period, if the agreement provides for one.

3.11 Defects and Defects Liability Period

According to Article 445 of the Brazilian Civil Code, an employer's right to reject goods due to latent defects or to claim a proper reduction in price due to such defects expires in 30 days if such goods are moveable, and in one year, in case the goods are immovable; in both cases, counted from the delivery of the goods (in case of construction works, from their substantial completion). Furthermore, as per Article 618 of the Brazilian Civil Code, the contractor whose scope includes the supply of the works' materials shall also be liable, exclusively with regards to defects affecting the safety and soundness of the works, for a period of five years after completion of the respective works, provided that employer sues the contractor within 180 days following the appearance of the relevant defect in this regard.

Furthermore, as per Article 446 of the Brazilian Civil Code, latent defects liability periods shall not be counted during contractual warranty peri-

ods, it being, therefore, possible to provide in contract for defects liability periods longer than those provided by law.

4. Price

4.1 Contract Price

Usually, construction contracts in Brazil provide that the contract price shall be the total and sole compensation to the contractor for the proper and timely completion of the works, comprising all related direct and indirect costs (including taxes, financial costs, costs for obtainment of insurance policies and financial guarantees, costs with inputs and services supplied by subcontractors and contractor's profit). The contract price is usually established in accordance with one of the following methods:

- lump sum price – the contractor agrees to carry out the works for a pre-agreed price. The price is subject to adjustment only in certain and limited circumstances, as specified in the contract (eg, variations, employer's default, events defined as employer's risks, escalation);
- price per unit – the contract price is determined by measuring the services and activities performed by the contractor for performance of the works and applying to such quantities' rates agreed by the parties or other sort of valuation; or
- maximum guaranteed price – the sum payable by the employer to the contractor is determined by measuring the work performed by the contractor and further applying agreed rates to the quantities measured or other sort of valuation until a cap is reached (ie, the maximum guaranteed price). Any costs above the maximum guaranteed price shall be borne by the contractor.

Contributed by: Thiago Fernandes Moreira, Alexandre Arlota, Natália Carvalho Mauad and Rafael Kasiarz, Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados

Since most construction contracts in Brazil are tailor-made, the specific conditions for establishing the contract price may vary for each contract and may combine aspects of the different pricing methods mentioned above and include incentives to ensure that the contractor uses its best efforts to limit the cost and/or the quantity of services and materials for completion of the works.

4.2 Indexation

Considering that construction works for large projects normally last for extended periods, it is a very common practice for construction contracts in Brazil to provide for price indexation. Under Brazilian law, nonetheless, any stipulation for indexation with a period of less than one year is considered null and void (Law No 10,192/2001, Article 2, First Paragraph).

However, price increases due to change orders, changes of scope and/or any other cause affecting the projects are perfectly admissible in any time interval, thus not being subject to the one-year time limit, which relates solely to correcting the loss of the monetary value of the currency (ie, inflation).

Construction contracts in Brazil are normally construed under the following indexation parameters.

It is most common for construction contracts in Brazil to provide for monetary correction or adjustment based on general or sectoral price indexes (such as *Índice Nacional de Preços ao Consumidor Amplo* – IPCA, *Índice Geral de Preços – Mercado* – IGP-M and *Índice Nacional de Custo da Construção* – INCC, specific for construction), as well as other indexes and market references that reflect variations in the specific production costs or inputs used in the

contracted works (eg, the use of price variation according to the London Metal Exchange in construction contracts for transmission lines, which are heavy in commodities). In addition, depending on the structure of the contract, other alternatives are also considered, such as parametric formulas and different indexes for different parts of the contracted scope.

The contractual allocation of the risk for large price fluctuations normally depends on the type of contract:

- for turn-key lump sum EPC contracts, on one hand, this risk of price fluctuation not encompassed by indexation is usually undertaken by the contractor – however, it is possible for the parties to allow for cost remedies in case of price fluctuations arising out of force majeure events; and
- for Guaranteed Maximum Price (GMP), open book and other management contracts, it is possible for the parties to agree on a different allocation of the risks, such as through the reimbursement of the actual cost (regardless of the fluctuation) or through a specific contingency for such price fluctuations.

4.3 Payment

It is common for construction contracts in Brazil to provide for an advance payment to be paid by the employer to the contractor at the beginning of the works to provide for the cash flow necessary for the performance of the works. Payment of the advance payment amounts is usually conditioned to the prior delivery by the contractor of an advance payment guarantee (generally a letter of credit or an insurance bond on the amount of the down payment) to be maintained in force until the advance payment is fully amortised.

Contributed by: Thiago Fernandes Moreira, Alexandre Arlota, Natália Carvalho Mauad and Rafael Kasiaz, Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados

To avoid late payment or non-payment by the parties, construction contracts in Brazil provide for various remedies that can be enforced by the non-defaulting party, the most common being:

- delay penalties – most contracts provide for delay penalties to be applied in case a party fails to timeously pay the other party any due amounts. Such penalties generally consist of applying monthly interest and escalation over the delayed amounts, plus a moratory penalty equivalent to a percentage of the delayed amounts;
- suspension – in case of the employer's delay in paying the contractor, if any undisputed amount surpasses a certain number of days, the contractor may suspend the works for the employer's fault, being entitled to claim extension of time and an increase in the contract price in order to deal with the impacts of such suspension;
- termination – either party is entitled to terminate the contract for cause in case the delay by the other party in paying an undisputed amount surpasses a certain number of days; and/or
- off-setting – the employer is usually entitled to off-set any uncontroversial amounts due by the contractor from any payments due by the employer to the contractor.

4.4 Invoicing

Although the specific conditions regarding invoicing of the works usually vary for each contract, especially considering that most construction contracts are tailor-made (without abiding to any standard forms), most contracts in Brazil usually abide by the following invoicing methods.

- Physical progress – The contract establishes unit prices for each service and activity to

be performed by the contractor. Periodically, generally on a monthly basis, the contractor presents to the employer a measurement report indicating quantities of each service or activity performed by the contractor during the period under review. Upon approval of the measurement report, the employer shall remunerate the contractor by applying the unit prices to the quantities indicated in the measurement report.

- Payment milestones – The contract connects the payment of specific portions of the contract price to the achievement by the contractor of specific milestones related to the performance of the works. Upon achievement of a milestone, the employer shall notify the contractor in the measurement report or by means of a payment request, presenting evidence of the achievement. Upon approval of the measurement report or payment request, the employer shall pay the amounts connected to such milestone to the contractor.

5. Time

5.1 Planning and Programme

Generally, the parties agree on a project schedule with the sequence of all activities to be performed, as well as the milestones and their relevant completion dates, which constitutes an integral part of the construction contract. Without prejudice to the project schedule, the contractor may also have the obligation to submit a working plan with the greatest possible level of details related to the scope of work to be executed. The working plan shall consider the completion dates established in the project schedule though.

Furthermore, most construction contracts provide for payment milestones, and the payments

Contributed by: Thiago Fernandes Moreira, Alexandre Arlota, Natália Carvalho Mauad and Rafael Kasiaz, Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados

are due by the employer upon achievement of the relevant milestones by the contractor, which shall be completed according to the provisions of the agreement.

There are, however, milestones that are subject to delay penalties, which may or may not coincide with payment landmarks. Some milestones are part of the critical path, and therefore, they must be achieved on their relevant completion dates, otherwise the commercial operation date is affected. Depending on the period of delay, a prolonged failure to timely complete a milestone may also lead to the early termination of the agreement by the employer.

At last, the employer usually issues a taking-over certificate upon completion of the works by the contractor and its acceptance by the employer, which sets out the commencement date of the commercial operation as well as the defects liability period. Upon the expiration of such period and the completion by the contractor of the relevant repairs or replacements of any defective works, the employer shall issue a final acceptance certificate.

5.2 Delays

Construction contracts typically include detailed requirements for the contractor to request an extension of time in case of delay due to events not caused by the contractor. The list of events entitling the contractor to request such extension of time is mostly exhaustive and includes events like suspension due to the employer's convenience or fault, failure by the employer to release the site area, failure by the employer to obtain its licences, and force majeure, among others, as further detailed in **5.4 Extension of Time**. In this case, the contractor shall submit a notice to the employer evidencing that the event effectively affected the relevant completion date.

The contractor may not be entitled to an extension of the commercial operation date in case the critical path is not affected.

The extension of time may be combined with the reimbursement of costs incurred by the contractor, as long as such costs are duly evidenced by the contractor. The list of events entitling the contractor to request the reimbursement of costs is also exhaustive, and such events are usually similar to the extension of time events with some exceptions, such as force majeure.

Independently, if the claim by the contractor relates to extension of time and/or reimbursement of costs, the contractor's entitlement to such remedy shall be conditioned upon the contractor presenting its claim timeously (ie, formulating the relevant claim against the employer and presenting it with supporting evidence, within a pre-defined timeframe), so as to avoid the employer being surprised with a late claim.

In case the delay is due to events caused by the contractor, however, the contractor is required to submit a recovery plan describing the measures to be taken to recover such delay, without prejudice to any delay penalties to be applied. The activities necessary for the implementation of the recovery plan will be exclusively borne by the contractor.

With respect to concurrent delays, the parties may contractually agree on the consequences of such delays, otherwise each party will be liable to the extent of its fault. Under construction contracts, it is common for the contractor to be entitled to an extension of time proportionally to the employer's period of delay. In this case, however, the contractor is not entitled to any reimbursement of costs, considering that the "time

Contributed by: Thiago Fernandes Moreira, Alexandre Arlota, Natália Carvalho Mauad and Rafael Kasiarz, Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados

but no money” approach has increased among contractual arrangements in the past years.

5.3 Remedies in the Event of Delays

In a manner that is different from the common law system, Brazilian law does allow the parties to establish penalties to be paid by the contractor in case of delay, which amount does not necessarily need to represent a genuine pre-estimate of losses incurred by the employer to be enforceable, although it may not exceed the value of the main obligation. Depending on the economic robustness of the parties and other circumstances, the judge/arbitrator may reduce any delay penalty, when it is deemed to be excessively high or if the main obligation has been partially performed.

Notwithstanding the foregoing, delay penalties may apply regardless of actual damages incurred by the employer. The delay penalties mainly seek to ensure the completion of the works by the commercial operation date.

As an extra mechanism to ensure timely completion, construction contracts may expressly indicate that the delay penalty shall be applied without prejudice to the right of the employer to claim compensation for damages arising out of the breach. However, such compensation is not common, given that the losses to which the employer may be subject by the delay in operation are often much higher than the full construction price – what results from most of such contracts not being a back-to-back arrangement in relation to the employer’s offtake commitments before third parties.

Moreover, the application of delay penalties does not prejudice the rights of the employer to require the performance of the breached obliga-

tion or to terminate the agreement depending on the period of delay.

5.4 Extension of Time

As further detailed in **5.2 Delays**, there is typically a specific provision related to requests for extension of time under construction contracts, which establishes the requirements to be complied with by the contractor, so as to entitle it to any such request.

The contractor may only request an extension of time if the event causing the delay is expressly listed under the construction contract. In this case, the contractor shall submit a notice within the period established in the agreement with details of the impacts caused by the event, together with relevant evidence.

The extension of time is usually proportional to the impacts of the delays caused to the contractor, although the commercial operation date may be only extended in case the critical path is effectively affected. Furthermore, the contractor is also not entitled to an extension of time if the reason for the delay arises from any act or omission of the contractor.

The extension of time is usually measured in a compatible manner with the impact of the delays suffered by the contractor. Accordingly, such extension of time is not necessarily proportional and, depending on the actual impacts suffered by the contractor, it will not be on the basis of one day of extension for each day of delay. In any case, the impacts on the project schedule shall be evidenced by the contractor.

Moreover, the employer may replace the extension of time with the increase of the contract price, at its discretion, as a compensation for the necessary acceleration measures to be taken by

Contributed by: Thiago Fernandes Moreira, Alexandre Arlota, Natália Carvalho Mauad and Rafael Kasiaz, Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados

the contractor to maintain the completion dates existing prior to the event that gave rise to the right to an extension of time, provided that such acceleration is technically feasible.

5.5 Force Majeure

According to the sole paragraph of Article 393 of the Brazilian Civil Code, force majeure means “an unforeseeable event, whose effects were impossible to avoid or prevent”. Unless otherwise expressly agreed, the party affected by a force majeure event shall not be liable for any damages arising therefrom.

The parties, however, may exclude specific events from the concept of force majeure, which usually includes changes in the economic or financial conditions of any of the parties, strikes or work stoppages (except for general strikes and/or work stoppages of a national nature), any act of any governmental authority, if such act could have been avoided by the affected party, among others.

As legal consequences of force majeure events, Article 607 of the Brazilian Civil Code provides the termination of service agreements due to the impossibility of performance caused by force majeure, while Article 625, item I of the Brazilian Civil Code entitles the contractor to suspend the civil works due to force majeure events.

Notwithstanding the foregoing, Brazilian law allows the parties to allocate liabilities with respect to force majeure despite the legal provisions. Thus, construction contracts generally provide for the consequences in case a party is affected by a force majeure event. The impacted deadlines shall be proportionally extended for the period that the force majeure and its consequences last. With respect to the losses and damages resulting from a force majeure event,

each party is most times liable for its own losses and damages in addition to any costs incurred during such period.

Moreover, a party may have the right to terminate the agreement without any compensation, indemnity or penalty should the force majeure event last longer than a contractually established period (typically, at least 180 days).

5.6 Unforeseen Circumstances

The Brazilian law provides the right to request the termination of a contract in case an extraordinary, unforeseen and supervening event affects the contractual obligations of a party, causing the economic-financial imbalance of the agreement. In this case, the compliance by the relevant party is still feasible, but it becomes excessively burdensome. Furthermore, according to Article 317 of the Brazilian Civil Code, where there is a clear disproportion between the value of the benefit due and that at the time of its performance, the judge may correct it, at the request of the relevant party, to ensure the actual value of the consideration to the extent possible. The right to the economic and financial rebalance of the agreement cannot be waived by the parties under the contract.

As further detailed in 3.5 Site, the contractual allocation of the risk of unforeseen site and soil conditions will depend on the type of construction contracts. Particularly in lump sum, turnkey agreements, the risk of such unforeseen conditions usually lies with the contractor, which has the opportunity to visit the site and to examine its actual conditions. Therefore, in this case, the contractor is usually not entitled to request an adjustment of the price, reimbursement of costs and/or extension of time due to any such condition.

Contributed by: Thiago Fernandes Moreira, Alexandre Arlota, Natália Carvalho Mauad and Rafael Kasiaz, Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados

5.7 Disruption

Most often, construction contracts expressly indicate the events entitling the contractor to request an extension of time and/or reimbursement of costs, which includes disruption events especially caused by the employer (please refer to 5.2 Delays).

In general, although there are several rights which do allow the employer to monitor the contractor's performance of the works and whether such performance is consistent with the schedule and technical specifications, should the employer affect the contractor's ability to perform the works due to unreasonable (or not expressly provided for under the contract) interference, the contractor may be entitled to formulate a disruption claim.

6. Liability

6.1 Exclusion of Liability

Although there is no specific legal provision in this regard, contractual provisions limiting or excluding liabilities arising from (i) fraud, gross negligence or wilful misconduct; (ii) death and bodily injuries; and (iii) breach of law, would be considered void, according to the case law and the majority of scholars. Commercially, the parties might as well expand the list of exclusions which are not subject to the liability cap for other events, such as third-party claims, environmental damages, breach of confidentiality duties, and breach of compliance provisions. It is not entirely uncommon either that the parties agree on establishing that amounts eventually paid by insurers should not count towards the liability cap and that the latter applies only to out-of-pocket compensation from the indemnifying party.

6.2 Wilful Misconduct and Gross Negligence

Wilful misconduct is defined as the intent to cause harm by means of a party's act or omission, or the undertaking of the risk that by acting in a certain way (or failing to act) a harmful outcome will result.

With respect to gross negligence, although there is no express legal text in Brazil defining it, the parties may agree on its definition for contractual purposes, which is most often similar to the common law definition of gross negligence. Due to the particularities of the scope of work and risks involved in a complex construction contract, the level of diligence and care expected for its performance is usually higher than other contracts.

6.3 Limitation of Liability

Subject to 6.1 Exclusion of Liability, the parties may contractually agree on any limitation of liability. It is usual to include an overall liability cap under construction contracts, which may vary according to the contract price and/or the project, without prejudice to the exceptions to be agreed by the parties, as detailed in 6.1 Exclusion of Liability. The overall liability cap may not surpass the amount of the main obligation though, and therefore, a cap exceeding 100% of the contract price may be challenged.

7. Risk, Insurance and Securities

7.1 Indemnities

According to Brazilian law, any losses and damages caused by one party to the other shall be indemnified by such party.

Furthermore, there is usually in construction contracts an indemnity provision, which establishes

Contributed by: Thiago Fernandes Moreira, Alexandre Arlota, Natália Carvalho Mauad and Rafael Kasiaz, Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados

the obligation of each party to indemnify and hold the other party harmless from and against any third-party claims due to any: (i) breach of any obligation established in the agreement; (ii) act, omission, negligence, recklessness, malpractice, inefficiency, breach of legal duty and/or duty of care by the contractor and/or any member of the contractor's personnel; (iii) breach of intellectual property of third parties; and (iv) failure by any of the parties in complying with the applicable laws.

These indemnity obligations, however, are subject to the exclusions and limitations of liability established in the construction contracts, except liabilities arising from third-party claims, which is most times an exception to the overall liability cap (please refer to **6.1 Exclusion of Liability** and **6.3 Limitation of Liability**).

Indemnity obligations are limited by law to direct losses and damages. Therefore, the parties are not liable for any indirect losses, nor punitive or consequential damages. However, since the concept of loss of profits is deemed as a direct damage under Brazilian law, it is necessary for it to be caveated contractually, otherwise the parties will be liable for it.

7.2 Guarantees

Typically, construction contracts provide for the obligation of the contractor to submit a performance bond to ensure the fulfilment of all of its obligations under such agreements. The performance bond may be a bank guarantee, an insurance bond, or a combination of both.

Considering the costs involved in obtaining and maintaining a bank guarantee throughout the term of the construction contract, the employers are currently more open to accept an insurance bond instead of a bank guarantee, even though

the latter gives more protection to the employer, considering that bank guarantees work as if they were on demand in Brazil and, therefore, local banks will rarely challenge or discuss in case of foreclosure.

The employer may also request the presentation of a parent company guarantee by the contractor as an alternative or complement to the bank guarantee or insurance bond. Such guarantee is usually intended to reinforce the financial standing of the contractor and give extra comfort to the employer in relation to the obligations that the contractor undertakes to comply with in the contract, especially when the contractor is a mere subsidiary or does not have a robust balance sheet compared to the price of its scope.

Finally, as a condition for the employer making any advance payment, the contractor generally needs to submit a bank guarantee to the employer in the same amount of such payment which will be enforceable until the full amortisation of the advances amount.

7.3 Insurance

Decree-Law No 73/1966 provides certain mandatory insurances, which are regulated by Presidential Decree No 61,867/1967, including in relation to construction works, comprising (i) civil liability for real estate contractors of urban zone constructions with respect to bodily injury and physical damage injuries and property damages; (ii) guarantees of payment of the borrower related to construction, including real estate obligations; (iii) buildings divided into autonomous units; (iv) fire and transportation of assets or goods belonging to legal entities located in or transported throughout Brazil; (v) bodily injury and physical damage caused by automobiles and vessels (or by their cargo) to individuals, regardless of whether such individuals are being

Contributed by: Thiago Fernandes Moreira, Alexandre Arlota, Natália Carvalho Mauad and Rafael Kasiaz, Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados

transported or not; and (vi) civil liability for land, maritime, river and lake transportation damages caused to cargo.

There are also other mandatory provisions on insurance specifically related to the construction industry, which include: (i) Article 1,346 of the Brazilian Civil Code: all buildings shall be covered by insurance against fire or total/partial loss; (ii) Article 13 of Law No 4,591/1964: all buildings or complex of buildings, including their units and common areas, shall be insured against fire and other casualties that may cause total/partial loss of the building; and (iii) Article 2 of Law No 4,864/1965: the buyer of a financed real estate building for housing purposes with a maximum value of 300 times the highest minimum wage in force in Brazil shall obtain temporary income life insurance (*seguro de vida de renda temporária*).

Nonetheless, in construction contracts, the contractor usually has a contractual obligation to obtain and maintain insurance covering the following: (i) engineering risks; (ii) property; (iii) third parties' civil liability; (iv) automobile liability; (v) employer's civil liability; (vi) bodily injury and physical damage and life coverage for contractor's employees; (vii) coverage for the transportation of equipment to be used in the construction works; and (viii) environmental risks. Instead of obtaining and maintaining separate insurances for each of the risks indicated above, the parties may agree to have an "all risks policy" to be obtained and maintained by the employer or the contractor, as applicable. In any case, the other party (and its subcontractors, if any) shall be included as a co-beneficiary under the policy, without prejudice to the waiver by the insurer of its subrogation rights. Furthermore, surety bonds or performance bonds are usually required under bid contracts regarding public or

private constructions to guarantee the fulfilment of the contracts.

Notwithstanding the foregoing, companies shall be assisted by an insurance broker to assess all risks related to a specific project and to determine the most suitable coverage.

7.4 Insolvency

Usually, construction contracts include "insolvency events" as one of the termination events, and therefore, any of the parties has the right to terminate the agreement in case an insolvency event occurs with respect to the other party.

The bankruptcy (similar to Chapter 7 of the US Bankruptcy Code) of a legal entity that is a party to a construction contract does not automatically terminate it, according to Article 117 of Law No 11,101/2005, which provides that the trustee may comply with the contract if it (i) reduces or avoids the increase of the indebtedness; or (ii) is necessary to preserve the assets of the bankrupt estate, assuming previous authorisation by the creditors' committee. The termination will eventually occur when the bankruptcy proceeding determines the cessation of the "business activity" of the company.

In case of a judicial reorganisation (similar to Chapter 11 of the US Bankruptcy Code), however, the relevant company continues with its business activity, and the trustee may not intervene in its management. Thus, in this case, a construction contract may be terminated by the parties' will, provided that such agreement includes the judicial reorganisation as a termination event, without prejudice to the right of the legal entity under judicial reorganisation to request an injunctive relief from the relevant court to prevent the counterparty from terminating it (*ipso facto* clause). The aim of the judicial reorganisation is

Contributed by: Thiago Fernandes Moreira, Alexandre Arlota, Natália Carvalho Mauad and Rafael Kasiaz, Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados

mainly to enable the company to continue with its activities. Thus, the termination in this circumstance has been restrained by Brazilian courts, as opposed to a bankruptcy proceeding, which is a definitive and unrecoverable act entitling the immediate termination of contracts.

7.5 Risk Sharing

Construction contracts usually provide for the risks to be assumed by each party. Even though all main construction risks are typically transferred to the contractor (which is a single point of liability), the employer may assume other risks, depending on the negotiation between the parties before the execution of the agreements, such as risks related to force majeure events, geological risks, among others.

There are also other contracting models that allow the parties to share risks, such as alliance agreements, in which the parties may align their commercial interests, and share the risks and rewards arising from the contract, by means of an inherent collaboration.

However, more common than alliance agreements (which are extremely rare in Brazil), EPC contracts may apply for bonuses and penalties schemes, in order to balance more evenly the risks and rewards.

The risks shared between the parties in construction contracts are considered in the price as a contingency, which is usually expressed as a percentage of the base estimate and represents an allowance for unforeseen costs that may arise during a construction project due to uncertainties. Contingencies may be overestimated or underestimated based on the level of detail and information obtained by the contractor.

8. Contract Administration and Claims

8.1 Personnel

Under construction contracts, the contractor commonly ensures it has sufficient and experienced personnel on site for the performance of the works and bears all related expenses and charges, including transportation, accommodation, food, medical care, among others.

These agreements also provide for the contractor's obligation to comply and make its personnel comply with the rules established in the Consolidation of Labour Laws and other applicable labour regulations, without prejudice to the internal health and safety rules of the employer.

Moreover, the contractor has generally the obligation to submit specific documentation on a monthly basis to the employer, as a condition for payment, to evidence the compliance with its labour and social security obligations, which includes, but is not limited to, the presentation of good standing certificates (*certidões de regularidade*) issued by the relevant governmental authorities.

It is also common for construction contracts to provide that: (i) the contractor's personnel shall not be deemed in any way employees of the employer; and (ii) the contract does not imply any joint and several or subsidiary liability of the employer. Therefore, the contractor shall usually defend and hold the employer harmless against any losses and damages arising from acts and omissions of any contractor's personnel.

Finally, some key personnel, such as the site manager and project director, may only be replaced by the contractor upon prior notice to the employer in this regard.

Contributed by: Thiago Fernandes Moreira, Alexandre Arlota, Natália Carvalho Mauad and Rafael Kasiaz, Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados

8.2 Subcontracting

Most often, the contractors have the right to subcontract portions of the works to any third party. The subcontracting is typically subject to the employer's prior written approval, unless it does not represent a critical subcontractor (ie, when the amount of the supply/service to be executed by the relevant subcontractor exceeds the amount defined in the contract in one or more contracts/purchase orders).

In general, as provided in **2.3 The Subcontractors**, the employer does not have a contractual relationship with subcontractors and the contractor remains fully and completely liable to the employer for the execution of the works and all of its obligations under the agreement, as well as for all liabilities arising out of any subcontracting. Thus, the contractor shall defend and hold the employer harmless against any losses and damages arising from any acts and omissions of its subcontractors.

8.3 Intellectual Property

Generally, the contract establishes which party owns the intellectual property rights in relation to the design and operation of the property/facility. In most cases, the contractor grants to the employer a royalty-free, perpetual and untransferable licence for the use of such intellectual property rights for the operation and maintenance, as well as the adaptation and modification of the project by the employer or its contractors.

The contractor also normally represents and warrants that the performance of its scope does not infringe any intellectual property rights of third parties, and, in case a dispute arises from an allegation of infringement of such rights, the contractor is obliged to immediately take the necessary measures to obtain a licence or right

of use over such intellectual property rights, so that the employer may regularly proceed with the use, operation and maintenance of the project, without any additional cost to the employer.

In case it is not possible to obtain the licence or right above, the contractor shall promptly modify the item or process under discussion by another item so that it does not violate intellectual property rights of third parties or replace the item or process under discussion with another item with equivalent functionality and effectiveness to the original item, and shall bear all the related costs, without prejudice to any compensation of losses and damages suffered by the employer and the obligation to hold it harmless from any claim of third parties in this regard.

9. Remedies and Damages

9.1 Remedies

In the event of breach, the non-defaulting party may be entitled to be indemnified for the losses and damages arising therefrom.

Moreover, in case of delay or other breaches (eg, default of performance and/or health, safety and environmental obligations), the parties may agree on specific penalties/liquidated damages to be applied (please refer to **5.3 Remedies in the Event of Delays**).

The non-defaulting party may also have the right to suspend or terminate the construction contract, depending on the breach. However, the contractor's suspension or termination events are usually narrower than the ones of the employer (please refer to **9.5 Retention and Suspension Rights** and **9.6 Termination**).

Contributed by: Thiago Fernandes Moreira, Alexandre Arlota, Natália Carvalho Mauad and Rafael Kasiaz, Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados

9.2 Restricting Remedies

Subject to **6.1 Exclusion of Liability**, the parties may contractually limit the remedies under construction contracts. Typically, the parties agree on an overall liability cap and exclusions of liability, as further detailed in **6.3 Limitation of Liability** and **9.4 Excluded Damages**.

Furthermore, it is usual for construction contracts to establish specific remedies to be applied in case of certain events. If the contractor does not achieve a key milestone on its relevant completion date, for instance, it generally pays delay penalties until the contractor recovers the delay. There are also penalties for other breaches, such as the ones applicable in the event of default of performance and/or health, safety and environmental obligations, as anticipated in **9.1 Remedies**.

In recent years, it has become more common in construction contracts for the parties to agree on a delay penalties cap which, if reached, may result in the termination of the agreement by the non-defaulting party. Such termination trigger linked to a delay liquidated damages cap draws the line when the delay becomes unbearable, and the continuance of the contract will be more harmful to the employer than its early termination.

9.3 Sole Remedy Clauses

Sole remedy clauses may be included in construction contracts in Brazil, although in most cases such provisions are restricted to penalties (including for delay and/or breach of performance requirements) as well as to technical warranty obligations related to the works. These clauses may be enforced through the dispute resolution procedure agreed by the parties in the agreement, which typically includes arbitration.

9.4 Excluded Damages

In general, losses of profits, as well as any indirect and/or consequential losses and damages under construction contracts, including, but not limited to, loss of opportunities and businesses, are excluded from the liability of the parties, except in case of (i) fraud, gross negligence or wilful misconduct, (ii) death and bodily injuries, and (iii) breach of law.

9.5 Retention and Suspension Rights

Construction contracts may establish the right of the employer to withhold a percentage of the contract price to be released on the commercial operation date, except for the amount corresponding to the items of an eventual punch-list, which is released upon its completion by the contractor and acceptance by the employer. The withholding amount works as an additional guarantee in case of the contractor's default.

Suspension rights are also available in construction contracts in Brazil. In general, the employer has the right to suspend the works for its convenience or an affected portion of the works for reasons attributable to the contractor, such as failure to comply with health and safety requirements. The contractor, in turn, may suspend the works in case of failure by the employer to make undisputed payments and other workstreams which may be affected by employer's failure to comply with the contract, such as the granting of continued site access and the employer's obtainment of its licences.

In case of suspension for the employer's convenience or due to the employer's default, the contractor shall be entitled to an extension of time and/or reimbursement of costs incurred due to such suspension, provided that such costs are reasonable and duly evidenced by the contractor.

Contributed by: Thiago Fernandes Moreira, Alexandre Arlota, Natália Carvalho Mauad and Rafael Kasiaz, Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados

In any case of suspension, as soon as the event triggering the suspension ceases, the contractor is required to resume the works within the period agreed by the parties in the construction contract.

9.6 Termination

According to the Brazilian law, a contract may be terminated in case of: (i) material breach; and (ii) unforeseeable extraordinary supervening event, which results in an excessively onerous obligation on the party claiming the termination and an extreme advantage to the other party, provided that, in such latter case, the defendant may prevent the termination if it agrees to equally modify the terms of the contract. It is worth mentioning that Brazilian courts and arbitration tribunals are quite restrictive in allowing termination on such basis, tending to prefer the rebalancing of the contract, as the safeguarding of contracts is a very robust principle under Brazilian law.

The employer may also terminate the agreement for its convenience, pursuant to Article 623 of the Brazilian Civil Code, as long as it pays for the expenses and profits related to the services performed, as well as a reasonable indemnity based on what the contractor would receive if the services were concluded. Instead of leaving the amount of the indemnity open, the parties may choose to establish (i) a lump-sum amount to be paid by the employer in case of termination for its convenience, or (ii) a schedule listing distinct amounts to be paid by the employer depending on the time the termination occurs.

Nonetheless, the parties may contractually agree on other termination events, which typically include: (i) termination for the employer's convenience; (ii) insolvency events; (iii) delay of the contractor to complete a milestone; (iv) breach not remedied within a specific cure period; (v)

force majeure events; (vi) employer's delay in making undisputed payments; and (vii) achievement of the overall liability cap and/or the delay penalties cap.

Although the consequences of termination vary, the following are the most common consequences:

- in case of termination by the employer due to the contractor's default, the contractor shall pay the greater of (i) the difference between the costs incurred by the employer to complete the works and the remaining balance of the contract price, and (ii) a termination fee, which is usually a pre-fixed percentage of the contract price; and
- if the contract is terminated by the contractor due to the employer's default, the employer shall pay the following: (i) the reasonable and evidenced costs incurred by the contractor to terminate the subcontracts; (ii) the expenses duly evidenced and incurred by the contractor for the acquisition of goods and services directly related to the works, which have not been delivered yet to the employer and whose orders cannot be cancelled; (iii) demobilisation costs; and (iv) termination fee, which is most times a pre-fixed percentage of the balance of the contract price.

The contractor shall be entitled to the payment of the works already performed, regardless of the cause of termination.

10. Dispute Resolution

10.1 Regular Dispute Resolution

Disputes regarding construction and projects in Brazil are usually settled by arbitration if no amicable solution is reached. International dis-

Contributed by: Thiago Fernandes Moreira, Alexandre Arlota, Natália Carvalho Mauad and Rafael Kasiaz, Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados

putes are widely settled under the rules of the International Chamber of Commerce (ICC), and, in domestic cases, the most relevant institution administering construction cases is the Centre for Arbitration and Mediation of the Chamber of Commerce Brazil-Canada (*Centro Brasileiro de Mediação e Arbitragem do Centro de Comércio Brasil-Canadá*) (CAM-CCBC). Other relevant institutions include the:

- Business Arbitration Chamber – Brazil (*Câmara de Arbitragem Empresarial – Brasil* – CAMARB) (Belo Horizonte, São Paulo, Rio de Janeiro, Recife, Brasília, Salvador, Goiânia and Itajaí);
- ICC Hearing Centre (launched in March 2018 in São Paulo to deal with Brazilian domestic cases);
- Centre for Conciliation, Mediation, and Arbitration of CIESP/FIESP (São Paulo);
- Brazilian Centre for Mediation and Arbitration (CBMA) (Rio de Janeiro);
- FGV Mediation and Arbitration Chamber (Rio de Janeiro); and
- Arbitration and Mediation Centre attached to the American Chamber of Commerce (AMCHAM) (São Paulo).

In addition, arbitration is provided for in the bid rounds in government contracts, as a strategy to attract foreign investors. Therefore, most construction agreements with state entities also have their disputes referred to arbitration.

Notwithstanding, in the absence of an arbitration clause in the agreement, most disputes will be resolved in the judicial courts, in accordance with the Brazilian law. Courts' jurisdiction can vary depending on the contract terms and whether the client, funder or contractor has brought the lawsuit. The courts of the defendant's domicile generally have jurisdiction over any lawsuit.

Despite this circumstance, the parties are entitled to include an election of the forum clause, which is commonly used in construction agreements (if this clause provides for dispute resolution in the judicial courts, the applicable law must be Brazilian law).

Additionally, disputes regarding construction and projects in Brazil may also be solved through mediation and dispute boards.

10.2 Alternative Dispute Resolution

Disputes regarding construction and projects in Brazil are usually settled by arbitration, in accordance with Federal Law No 9,307/1996 (Brazilian Arbitration Law). In addition to arbitration, mediation and dispute boards are the most used alternative dispute resolution methods in Brazil, usually jointly with and without prejudice to arbitration.

When opting for arbitration, the parties may choose the number of arbitrators, the seat and language of the arbitration, as much as several other procedural features (eg, the applicability of international soft law documents, the applicability of emergency arbitrator provisions, the establishment of specific evidence rules and proceedings, among others). Under Brazilian Arbitration Law, an arbitral award is equated to a judicial award, and it can only be subjected to an annulment proceeding, under a few exhaustive legal hypotheses, within a 90-day period from its receipt by the relevant party. If the arbitration seat is not in Brazil, the arbitral award must be subjected to a homologation proceeding by Brazilian courts (*exequatur*).

The adoption of mediation in both judicial and extra-judicial proceedings is regulated by Law No 13,140/2015 (Mediation Act). It governs mat-

Contributed by: Thiago Fernandes Moreira, Alexandre Arlota, Natália Carvalho Mauad and Rafael Kasiaz, Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados

ters such as non-attendance penalties and the appointment and qualification of mediators.

Dispute boards are usually assembled to deal with technical disputes that arise during the performance of the contract. A dispute board will recommend a solution by a dispute resolution board or will directly solve the issue itself as a dispute adjudication board. There are also combined dispute boards, mostly for contracts that adopt ICC and CAM-CCBC arbitration clauses.

There is a growing trend of dispute boards being provided for in construction contracts in Brazil, and, as a result, some Brazilian cities have created laws to regulate the possibility of dispute boards in contracts entered into by the public authorities of those cities, such as São Paulo (Municipal Law No 16.873/2018), Belo Horizonte (Municipal Law No 11.241/2020) and Porto Alegre (Municipal Law No 12.810/2021).

Additionally, Law No 14,133/21 (Brazilian New Public Procurement Law), which replaces Law No 8,666/93, allows for amendments to contracts to provide for alternative means of dispute resolution, such as dispute resolution boards.

Expert determination is also provided for in some infrastructure contracts. However, this feature is more usual in relation to cross-border and international agreements. There are no statutes in Brazil governing expert determination.

Trends and Developments

Contributed by:

Leonardo Toledo da Silva, Marcelo Marchetti, Roberto Oliveira and Luis Claudio Yukio Vaturi
Toledo Marchetti Advogados

Toledo Marchetti Advogados stands out as Brazil's leading law firm, exclusively dedicated to the infrastructure and construction sectors. With a distinguished team boasting over 20 years of experience, it provides comprehensive legal services tailored to the intricate challenges of these industries. Its approach integrates deep sector-specific knowledge and collaborative strategies to effectively address complex legal issues, guiding clients from investment decisions to asset maturity. The team understands infrastructure from a cyclical perspective, categorising it into three key phases: Development,

Implementation (Capex), and Operation (Opex). For each phase, it offers tailored solutions to meet diverse requirements. The firm specialises in leveraging the "Infra Cycle" for investment and offers legal solutions across diverse sectors, including power, transportation, oil and gas, urban development, telecommunications, social infrastructure (such as prisons, schools, hospitals), green projects, and industrial plants. Its efforts and strategic orientation have earned recognition from major national and international legal publications, underscoring its commitment to excellence.

Authors



Leonardo Toledo da Silva is specialised in infrastructure and construction law. With experience in projects, arbitration, and alternative dispute resolution, he excels as

a lawyer and arbitrator. His expertise is notable in project development, where he is regarded as a top-tier lawyer in designing and negotiating complex construction contracts. Furthermore, he holds a Master's and PhD in Commercial Law from the University of São Paulo and serves as a professor of Construction Law in the Master's programme at FGV Direito-SP. Leonardo was a Visiting Scholar at King's College London and served as president of the Brazilian Institute of Construction Law.



Marcelo Marchetti is an expert in both private and public sector projects, with a strong emphasis on contract management in the infrastructure and construction industries. He has accumulated

extensive experience through pivotal roles in the legal departments of leading engineering and construction companies, spanning sectors such as energy, oil and gas, mining, logistics and sanitation. His work is rooted in a deep understanding of the legal landscape that governs major construction and infrastructure projects. He has won awards for excellence in case management and for his leadership and significant contributions to the field of contract and commercial management, among other accolades.

BRAZIL TRENDS AND DEVELOPMENTS

Contributed by: Leonardo Toledo da Silva, Marcelo Marchetti, Roberto Oliveira and Luis Claudio Yukio Vaturi, Toledo Marchetti Advogados



Roberto Oliveira is a seasoned lawyer specialising in corporate law and M&A, with extensive expertise in FDI, foreign exchange, and banking law. His professional journey spans

Brazil and the United States, where he has handled a variety of investment matters, including greenfield and brownfield investments from prominent countries such as the US, Canada, Italy, France, UK, Spain, Luxembourg, Switzerland, China, Japan, UAE, and Argentina. Roberto's academic credentials include an MBA from the Massachusetts Institute of Technology – Sloan School of Management (Cambridge, MA), an LLM from the University of São Paulo Law School, and a Bachelor of Law from the same institution.



Luis Claudio Yukio Vaturi is a tax and customs lawyer specialised in infrastructure and construction. With expertise in M&A, tax planning, foreign direct investment, customs, and

foreign exchange law, he brings extensive experience in administrative and judicial litigation. Starting his career at a major law firm, he served national and international clients across diverse industrial sectors. Yukio holds LLM degrees in Tax Law from FGV/SP and Ibmec/SP, along with a Bachelor of Law from the University of São Paulo. He is also author of many articles and studies, and serves as a Professor of Tax Planning at Pontifical Catholic University of São Paulo (PUC/SP).

Toledo Marchetti Advogados

Rua Fidêncio Ramos, 195
8th floor Vila Olímpia
São Paulo
SP, 04551-010
Brazil

Tel: +55 11 3195-5410
Email: contato@toledomarchetti.com.br
Web: www.toledomarchetti.com.br



Contributed by: Leonardo Toledo da Silva, Marcelo Marchetti, Roberto Oliveira and Luis Claudio Yukio Vaturi, Toledo Marchetti Advogados

“Brazil is not for beginners”. This is a questionable but common saying in Brazil. It implies that working in Brazil requires highly prepared companies accustomed to the country’s peculiarities and unique culture. While Brazil may have been more challenging for entrepreneurs in the past, this assertion is becoming less true in the present day. Nonetheless, it is undeniable that opportunities in project development in Brazil remain substantial. This article aims to present some of these challenges and opportunities, as well as comment on current trends in the Brazilian landscape for the years to come.

Opportunities in Project Development in Brazil

Overall opportunities

Promising investment opportunities in Brazil’s infrastructure are anticipated in the coming decade, particularly as the country’s transportation and logistics infrastructure remains insufficiently developed. Brazil’s historical underinvestment in infrastructure has led to a backlog of projects, many of which boast readily demonstrable economic and technical viability.

A good example is the suite of projects related to Brazil’s notorious challenge of effectively disposing of its entire agribusiness-related crop. Brazil is working on enhancing its infrastructure to support the growth of its agribusiness sector. Key initiatives include investing in railways like Ferrogrão and FICO, expanding and modernising ports, improving waterways like the Tietê-Paraná Waterway, upgrading highways, and building more storage facilities. Technology integration is also crucial for optimising transportation and logistics. These efforts aim to boost efficiency in the agricultural sector and stimulate Brazil’s economy.

In 2024 and beyond, Brazil’s infrastructure investment market will be robustly focused on key sectors such as transportation, energy, and sanitation. As mentioned above, Brazil is usually behind in investment in infrastructure. Due to that, considering its size, and the conscious that expansion supports sustainable development and economic growth, there will be many opportunities.

As usual, the Transportation sector is seeing the largest injection of funds, with projects that span highways, urban mobility, and ports. Significant investments include BRL220.9 billion allocated under the PAC (Federal Government Programme for Acceleration of Growth), aiming to improve the logistical backbone of the country.

Renewable energy, particularly wind and solar power, is a major focus area of investments, driven by Brazil’s rich array of sustainable resources. The forecast expects to increase 73,000 MW in Brazil’s installed capacity for electric power generation. About half of this expansion is based on wind, solar, biomass, and small hydro sources, according to EPE, the Brazilian research energy company.

With a projected investment of BRL195.659 billion by BNDES Projects Hub, the sanitation sector is also a priority, pressured by the deadlines imposed by Law No 11,445 from 2007, known as the National Basic Sanitation Law.

These sectors are supported by various government initiatives, public-private partnerships, and direct private investments.

Brazil is in a unique position in energy transition projects

Brazil is a world leader in renewable energy. Out of the 227 GW of the Brazilian energy system,

Contributed by: Leonardo Toledo da Silva, Marcelo Marchetti, Roberto Oliveira and Luis Claudio Yukio Vaturi, Toledo Marchetti Advogados

more than 86% comes from renewable sources (led by large hydro plants, followed by solar and wind), and almost two-thirds of the non-renewable sources come from natural gas. Solar sources have substantially increased within the distributed micro- and mini-generation systems, reaching 27.7 GW in 2024. Thus, Brazil has already transitioned into a green energy matrix.

Nevertheless, the country continues its efforts to maintain its energy from renewable sources. On the one hand, 144 GW of photovoltaic power plant licences have been granted to investors, representing more than USD100 billion in (needed) investments in the upcoming years only in solar; on the other hand, there are active governmental discussions related to frameworks for offshore wind power and green hydrogen. Brazil's leadership, in discussing these new technologies, may help other countries with less favourable geography transition into renewable matrices. With an extensive coastline and friendly weather, should green hydrogen prove a viable and cost-effective energy alternative, Brazil could be an exporter, helping other countries in their transition.

Challenges in Project Development in Brazil

Developing capital projects in the infrastructure sector is inherently challenging. Decreases in demand, increases in input prices, construction implementation, financing strategies, among other factors, typically pose significant challenges to infrastructure projects. However, in the near future, specific challenges to the Brazilian landscape can be anticipated.

Political and regulatory environment

In Brazil's recent election, President Lula won by a narrow margin, facing a conservative House. While the government has passed crucial laws like the fiscal framework and tax reform, issues

like tax regulation and administrative reform remain unresolved. The upcoming House president election on October 6th will shape the legislative agenda, with President Lula and current House President Artur Lira at odds over priorities. This dispute could stall discussions on vital matters, hindering long-term investment projects.

Despite recent regulatory approvals in Brazil's sanitation and railway sectors, the prevailing political uncertainty remains a significant concern for infrastructure projects. This instability underscores the challenges of navigating regulatory frameworks, potentially impacting project timelines and investor confidence. Ensuring regulatory clarity and consistency becomes crucial for project implementation and attracting investments. The evolving political landscape may necessitate discussions on refining regulations across various infrastructure sectors to support Brazil's sustainable development goals.

Recent Brazilian Tax Reform

The complexity of Brazil's tax structure presents a significant challenge for the infrastructure sector, which relies heavily on stable and predictable financial frameworks. With taxation occurring at three distinct levels – Federal, State, and Municipal – and nearly 100 taxes and tariffs in place, navigating the system becomes a formidable task.

The recent Tax Reform, enacted in December 2024, aimed at simplifying the system by implementing a VAT system to replace five main taxes, demonstrates an attempt to streamline processes. However, the final outcome created two new taxes instead of the intended simplification. While this reform partially achieves its objectives, it fails to address the underlying complexity and procedural hurdles inherent in the tax system.

Contributed by: Leonardo Toledo da Silva, Marcelo Marchetti, Roberto Oliveira and Luis Claudio Yukio Vaturi, Toledo Marchetti Advogados

The complexity is further compounded by the transition period spanning four years, during which both old and new taxes will co-exist. This uncertain period will significantly impact investments, planning, business operations, contracts, and other relationships within the infrastructure sector. With numerous laws and projects under discussion at various legislative levels, the future landscape remains uncertain, demanding heightened attention from taxpayers and stakeholders alike.

Challenges in construction

Due to increased investment prospects, concerns arise about meeting current and future demands. In 2022, Brazil saw its highest investment rate in eight years, with the federal government planning annual investments of approximately BRL240 billion in infrastructure from 2024 to 2025.

The Brazilian construction sector has notably shifted since Car Wash Operation. Newcomers, including foreign firms, now compete in sectors once dominated by local giants. However, there is a perception that this shift has not fully settled, with new entrants still lacking the operational prowess of their predecessors.

The equation is straightforward: high demand in a context of reduced construction capacity could lead to project failures, escalating costs, and delays. This is exacerbated by traditional contracting methods, which tend to isolate project risks, often resulting in an “every man for himself” approach to problem-solving, whether by transferring risks to suppliers or bearing them solely as the project owner’s burden.

New Trends

It is also possible to anticipate some trends that have been emerging in recent years and will continue in the near future.

Non-recourse funding

The first trend worth mentioning relates to project finance structures.

Historically, Brazilian infrastructure projects have been subject to either full-recourse or limited-recourse funding, particularly with the participation of the BNDES (National Development Bank) in most projects. However, non-recourse financing for infrastructure projects highlights significant developments in Brazil.

The most recent projects with non-recourse financing include the Jaiba III solar project (Recurrent Energy, in April 2024), which received USD70 million from Banco do Nordeste do Brasil S.A. (BNB), and Eneva, a Brazilian power generator, which plans to utilise non-recourse financing by issuing USD475 million in simple debentures (capital markets) to refinance existing assets. In its turn, subway’s Line 6 of the city of São Paulo utilised a limited recourse financing structure, securing more than USD1 billion for the construction and operation of the project.

Brazil’s recently enacted Law 14,801/2024, which introduces “New Infrastructure Debentures”, will stimulate investment by offering more favourable conditions for both issuers and investors in infrastructure projects. Such a new law, coupled with the Brazilian federal investment strategy, particularly under the Novo PAC programme, may drive a new chapter of non-recourse financing in Brazil, particularly for those projects related to energy (renewable sources), transportation infrastructure and sanitation.

Contributed by: Leonardo Toledo da Silva, Marcelo Marchetti, Roberto Oliveira and Luis Claudio Yukio Vaturi, Toledo Marchetti Advogados

The consolidation of dispute boards

The rise in the use of dispute boards, particularly permanent dispute adjudication boards (DABs), as a method of resolving conflicts in construction contracts is indeed a significant trend. While the concept of DABs has been around globally for some time, their adoption in Brazil has gained momentum in recent years, reflecting a growing recognition of the need for effective dispute resolution mechanisms in complex construction projects.

In the context of Brazil, the involvement of Arbitration Chambers in administering DABs is a notable development. This unique approach underscores the country's commitment to innovation in dispute resolution processes within the construction industry. Of course, since it is an innovation, it will also be important for the Chambers to customise a more informal procedure administration in order not to make the DABs look very much like an arbitration procedure.

The importance of legal contract management

In Brazil, during the construction stage of projects, Legal Contract Management will be more important than ever.

In an increasingly complex business environment, conceptual frameworks are used to describe the nature of our world and its difficulties, as BANI, which stands for “Brittle, Anxious, Nonlinear, and Incomprehensible”, and try to update the previously popular VUCA model (Volatile, Uncertain, Complex, Ambiguous).

Besides that, future relationships in business-to-business tend to be more collaborative, transparent, and mostly service based.

In such context, the market is progressively recognising the strategic role of effective contract management to enhance operational efficiency, reduce risks, and boost overall profitability. However, technological advancements are accelerating the evolution of the practice of contract management.

There is a shift from viewing contracts merely as legal documents to recognising them as foundational tools for building strong, sustainable business relationships. This approach emphasises the importance of clear communication, mutual benefits, and long-term partnership rather than just binding agreements, reflecting a more relational and less adversarial strategy in contract negotiations.

In conclusion, the landscape of contract management is continually evolving. Simply having a well-crafted, signed contract is no longer sufficient; it must also be meticulously managed from a legal perspective. To achieve this, employing legal methodologies developed by experienced attorneys in such area is crucial. Moreover, integrating data analysis and utilising the correct tools can significantly enhance the effectiveness of contract management in today's environment.

Innovative and collaborative construction contracts

One notable trend in the construction industry concerns the evolution of contract arrangements for infrastructure projects. Traditional construction contracts have been questioned by many prominent owners due to perceived misalignment of interests. Consequently, these owners are increasingly exploring alternative contract approaches, often incorporating Early Case Involvement (ECI). This collaborative approach involves suppliers and owners working together

Contributed by: Leonardo Toledo da Silva, Marcelo Marchetti, Roberto Oliveira and Luis Claudio Yukio Vaturi, Toledo Marchetti Advogados

in the pre-construction phase to enhance project planning, budgeting, and design optimisation.

These new contract models also emphasise transparency in pricing and incentivise alignment of interests between parties. They often incorporate bonus structures aimed at achieving common goals such as optimising capital expenditures, expediting revenue generation, and improving safety and environmental standards. Notably, Enel Green Power has implemented one such arrangement using an FAC-1 (Framework Alliance Contract). In this case, the FAC-1 was used to organise the integration of various key suppliers under a joint governance structure to foster collaboration for project success.

Conclusion

In Brazil's construction and infrastructure sector, challenges persist alongside abundant opportunities. Despite historical underinvestment, promising prospects in transportation, energy, and sanitation sectors signal robust growth potential. Renewable energy initiatives, innovative financing like non-recourse funding, and dispute resolution mechanisms reflect Brazil's commitment to sustainable development. However, political and regulatory uncertainties, tax complexities, and construction capacity constraints remain challenges. However, proactive measures such as regulatory clarity, collaborative contracts, and advanced legal contract management can mitigate risks. By addressing challenges and capitalising on opportunities, Brazil can pave the way for resilient infrastructure and global competitiveness.

BULGARIA

Law and Practice

Contributed by:

Victoria Penkova and Yavor Tankov
Penkova & Partners Law Firm



Contents

1. General p.87

- 1.1 Governing Law p.87
- 1.2 Standard Contracts p.88

2. Parties p.88

- 2.1 The Employer p.88
- 2.2 The Contractor p.89
- 2.3 The Subcontractors p.89
- 2.4 The Financiers p.90
- 2.5 The Designer p.90

3. Works p.90

- 3.1 Scope p.90
- 3.2 Variations p.91
- 3.3 Design p.91
- 3.4 Construction p.91
- 3.5 Site p.92
- 3.6 Permits p.92
- 3.7 Maintenance p.93
- 3.8 Other Functions p.93
- 3.9 Tests p.93
- 3.10 Completion, Takeover and Delivery p.94
- 3.11 Defects and Defects Liability Period p.94

4. Price p.95

- 4.1 Contract Price p.95
- 4.2 Indexation p.95
- 4.3 Payment p.95
- 4.4 Invoicing p.96

5. Time p.96

- 5.1 Planning and Programme p.96
- 5.2 Delays p.96
- 5.3 Remedies in the Event of Delays p.97
- 5.4 Extension of Time p.98
- 5.5 Force Majeure p.98
- 5.6 Unforeseen Circumstances p.98
- 5.7 Disruption p.99

6. Liability p.99

- 6.1 Exclusion of Liability p.99
- 6.2 Wilful Misconduct and Gross Negligence p.99
- 6.3 Limitation of Liability p.99

7. Risk, Insurance and Securities p.100

- 7.1 Indemnities p.100
- 7.2 Guarantees p.100
- 7.3 Insurance p.100
- 7.4 Insolvency p.101
- 7.5 Risk Sharing p.101

8. Contract Administration and Claims p.102

- 8.1 Personnel p.102
- 8.2 Subcontracting p.102
- 8.3 Intellectual Property p.103

9. Remedies and Damages p.103

- 9.1 Remedies p.103
- 9.2 Restricting Remedies p.104
- 9.3 Sole Remedy Clauses p.104
- 9.4 Excluded Damages p.104
- 9.5 Retention and Suspension Rights p.104
- 9.6 Termination p.105

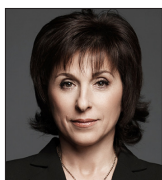
10. Dispute Resolution p.106

- 10.1 Regular Dispute Resolution p.106
- 10.2 Alternative Dispute Resolution p.106

Penkova & Partners Law Firm is a boutique firm with a focus on business law. It was established 2000 and is located in Sofia. The team is comprised of five lawyers, two paralegals and two external legal consultants. For more than 20 years, the firm has acquired considerable experience in the area of construction law and its related fields: urban planning, real estate and property law, construction contracting and subcontracting, financing and securitisation agreements, public procurement procedures,

as well as contentious matters. The law firm provides legal advice in all stages of construction: from the initiation of the urban development procedures until the commissioning of the construction. The firm has consulted clients on infrastructure (including regulated under FIDIC forms of contract) projects of national significance, railway projects, and some of the largest prospective mixed-use residential and office projects in the country.

Authors



Victoria Penkova is the managing partner at Penkova & Partners, and has been practising law since 1990. She has extensive experience in the fields of construction, real

estate, contract and commercial law and M&A. Victoria provides legal consultations in all phases of construction and represents clients in court and arbitration proceedings. Qualified in practical use of FIDIC conditions of contract and management of contract claims and resolution of disputes, she is a chair of the Bulgarian Society of Construction Law and is included in the list of adjudicators at the Bulgarian Association of Architects and Consulting Engineers. Victoria is fluent in English.



Yavor Tankov has been a member of Sofia Bar since 2018 and joined Penkova & Partners in 2019. His practice is focused predominantly on the fields of contract and commercial law

while he also has experience in construction and public procurement matters. Yavor provides legal consultancy and procedural representation on multiple matters to various clients, including a contractor under a railroad infrastructure project. He has completed an introductory course on the practical use of FIDIC Conditions of Contract and a course on matters of arbitration at the Bulgarian Chamber of Commerce and Industry. Yavor is fluent in English and Spanish.

Penkova & Partners Law Firm

9 Hristo Belchev Street
Floor 2
Sofia
1000
Bulgaria

Tel: +359 2986 79 07
Email: vpenkova@penkova-partners.com
Web: www.penkova-partners.com



1. General

1.1 Governing Law

The Bulgarian legislative structure is contained in primary legislation adopted by the National Assembly and secondary legislation (regulations, ordinances, decrees) adopted by the Council of Ministers and respective Ministers.

Essential laws regulating construction relations, outside of the applicable EU legislation, are:

- Spatial Development Act (SDA);
- Development of Black Sea Coast Act;
- Concessions Act;
- Public Procurements Act (PPA);
- Technical Requirements to Products Act;
- Bulgarian Construction Chamber Act;
- Obligations and Contracts Act (OCA);
- Commerce Act;
- Code of Civil Procedure (CCP);
- International Commercial Arbitration Act (ICAA);
- Mediation Act (MA); and
- Multiple sector-specific laws in the fields of telecoms, agriculture, forests, waters and environment protection.

The construction contract is regulated by the SDA, which specifies the essential responsibilities of the parties. A large part of the responsibilities regulated by the SDA is of an administrative nature, and their fulfilment is necessary for the due and accurate performance of construction contracts. Matters such as payment, non-performance, liability for default, damages, compensation and penalties are regulated by the provisions of the OCA and the Commerce Act.

Ordinances regulating specific construction-related matters are:

- Ordinance No 3/31.07.2003 on the Drawing up of Acts and Protocols During Construction (“Ordinance No 3”);
- Ordinance No 2/31.07.2003 on the Commissioning of Constructions in the Republic of Bulgaria and the Minimal Warranty Periods for Executed Construction and Installation Works, Facilities, and Construction Sites (“Ordinance No 2”); and
- Ordinance No 4/21.05.2001 on the Scope and Contents of Investment Designs (“Ordinance No 4”).

1.2 Standard Contracts

The use of standard contracts, such as FIDIC Conditions of Contract, is not a common practice for small and/or privately commissioned construction projects in Bulgaria.

When it comes to public projects which are financed in whole or in part by international financing institutions or through funds of the European Union, the SDA expressly provides that FIDIC conditions of contract may be used by the parties. Thus, and especially in large infrastructure projects, the use of the first editions of the Red and Yellow books is relatively common and the Particular Conditions are modified in accordance with the mandatory provisions of the Bulgarian construction legislation.

Standardised documents and requirements are applicable to certain public procurement contracts.

2. Parties

2.1 The Employer

The employer is the owner of the plot of land on which the construction is to be performed, or the person possessing an in rem right to construction or the right to construct on another person's property by virtue of the SDA or of another special law.

In the private sector, the employer can be any privately owned legal entity or legally capable natural person(s). In the public sector, the employer is usually a governmental (minister, agency) or municipal (mayor) authority, or a publicly owned company having the right and/or charged with the operation or development of the relevant infrastructure or facilities.

The essential obligations of the employer are to:

- procure everything necessary for the initiation of the construction;
- provide the designs needed for the construction (in contracts for construction);
- furnish the construction permit;
- provide access to the site;
- approve the works executed in accordance with the designs; and
- pay the agreed remuneration.

Under the SDA, the employer is also responsible for:

- carrying out all necessary co-ordination and permission procedures with the relevant urban development, traffic safety, environmental safety, cultural heritage and other authorities and utility companies;
- procuring documents necessary for the design conformity assessment;
- initiating the construction only after the necessary construction, construction supervision and author supervision agreements are concluded;
- drawing up of all acts and protocols during construction in accordance with Ordinance No 3;
- commissioning the construction; and
- adhering to the provisions of the technical passport of the construction.

The employer has the right to:

- inspect the works at any time, without hindering the activities of the contractor; and
- accept the construction works, executed in accordance with the approved designs.

The employer generally has no direct contractual relation with the subcontractors.

2.2 The Contractor

Construction works are assigned by the employer on the basis of a written contract between the employer and the contractor.

The contractor is a legal entity (or a natural person), having engaged natural persons with the necessary technical legal capacity. Joint ventures are often contractors of complex infrastructure projects.

With the exception of the simplest projects, construction can be performed only by contractors – traders registered in the Central Register of Professional Builders (CRPB) with the Bulgarian Construction Chamber.

The contractor is responsible for:

- carrying out the construction, at its own risk and with its own means, in accordance with the approved designs;
- the quality and due performance of the construction works and their fitness for purpose;
- the quality of the materials used for the construction, where it is agreed that the materials will be procured by the contractor;
- immediately notifying the employer if the design or the materials provided by the employer are inappropriate for the due performance of the construction;
- any deviations from the assignment or defects of the works; and
- providing warranty for the performed construction for the duration of the statutory warranty period under Ordinance No 2,

and has to ensure that:

- the construction is executed in compliance with the issued construction documents and the essential requirements for constructions

and in conformity with the relevant health and safety, environmental protection, noise, waste disposal, hygiene, fire safety, accessibility and sustainability requirements;

- the materials, articles, products, etc, compliant with the essential requirements for construction are used in accordance with the respective technological requirements;
- the acts and protocols during construction are drawn up in a timely manner;
- the executive and other technical documentation is duly prepared and appropriately stored;
- the order book and the construction acts and protocols are appropriately stored and available for presentation;
- the construction works performed are within the scope of the CRPB registration of the contractor; and
- natural person(s) with the necessary legally required capacity to implement the technical management of the construction are employed.

2.3 The Subcontractors

The contractor may subcontract certain types of construction and installation work or parts (phases) of the construction. Subcontractors involved in construction should be registered with the CRPB – see **2.2 The Contractor**.

The relations between the contractor and the subcontractors are governed by an agreement. Generally, the subcontractor is contractually liable to the contractor and not to the employer, and the contractor is liable to the employer for the actions and omissions of the subcontractor. Nonetheless, the parties may agree that if the subcontractor is approved by the employer, the subcontractor is directly liable to the employer.

Payments to the subcontractors are usually conditional upon approval of the relevant construction works by the employer and, in some instances, conditional upon payment by the employer.

2.4 The Financiers

Private projects in Bulgaria are typically financed by banks through loan agreements between the bank and the employer. Such loans are usually secured by special pledge over the employer's commercial enterprise and/or a contractual mortgage over the plot of land, the future building, or the individual premises therein.

The financier is not a party to the construction contract and does not interfere in the relations between the employer and the contractor. The payments under the financing agreement may be conditional upon reaching certain milestones.

Public projects are often financed by funds of the European Union and co-financed by the Bulgarian state.

2.5 The Designer

The designer is a natural or legal person, having engaged natural persons with the necessary designers' capacity. All architects and engineers, who prepare the designs for the construction, shall be registered with the Chamber of Architects and the Chamber of Engineers in the Investment Design respectively. In general, architects and engineers from EU member states, EEA states, Switzerland and third countries can exercise their profession in Bulgaria subject to recognition of their professional qualification.

The designer is responsible for:

- notifying the employer in case the provided technical assignment/specifications or other requirements are inappropriate for the preparation of the designs; and
- preparing the designs in accordance with the relevant requirements for construction, the provisions of Ordinance No 4 and the detailed development plan.

The designer performs the author's supervision and is liable for its actions in this regard.

The instructions of the designer relating to its copyright, for the accurate performance of the investment designs, are registered in the order book and are mandatory for all participants in the construction process. The relations between the employer, the designer and the contractor are outlined in 3.3 Design.

3. Works

3.1 Scope

The scope of works depends on the type of contract. Under contracts for construction, the scope of works usually encompasses all construction works necessary for the completion and commissioning of the construction in accordance with the designs and bill of quantities, at the risk of the contractor and with the contractor's own materials.

Under design-and-build contracts, the employer usually provides its requirements/technical specification, as the scope of works covers the preparation of all design in accordance with the requirements/specifications of the employer, the procurement of the necessary materials, and the performance of all construction works needed

for the completion and commissioning of the construction.

3.2 Variations

In the private sector, the parties are free to agree on the circumstances that lead to a change in the scope and price of the contract, as well as the relevant mechanisms for their determination.

In the case of business frustration – meaning circumstances which arise after the contract is concluded – which the parties could not and would not be obliged to foresee, the continuation of the contract is contrary to justice and good faith, and either party may request the court to modify the contract in whole or in part.

Variations Requested by the Employer

The variations in the scope of works as a result of a change in the employer's investment intentions, a change to the design or assignment of additional works, result in concluding of an additional agreement on the scope, cost and time for those additional works.

Variations Requested by the Contractor

The contractor has two statutory options under the OCA to request scope and price variations.

- The contractor shall immediately notify the employer if the design or material provided by the employer are inappropriate for the due performance of the construction and request changes to the design or supply of suitable material. Failure to do so renders the contractor liable for damages caused to the employer. If a change to the design results in a change of the scope of the works and assignment of additional works, the contractor shall be entitled to remuneration for the same.

The contractor shall be entitled to an adjustment of the price if, during the term of the contract, the duly determined price for the material or labour is changed, notwithstanding that the price has been agreed in full.

In the event of additional unforeseen works necessary for the performance of the contract and resulting from various technological reasons or from mandatory prescriptions of control bodies, the contract price shall be adjusted.

Variations in the scope and price of contracts under the PPA is permitted in the special provisions of the PPA.

3.3 Design

Under contracts for construction, the responsibility for the designs' preparation vests with the employer. The contractor shall review the designs and immediately notify the employer of any deficiencies therein.

Under design-and-build contracts, the contractor is responsible for the designs' preparation.

The contractor is responsible for carrying out the construction in accordance with the approved designs.

The Bulgarian legislation prohibits the same person from participating in the construction process both as a designer and as a builder.

The designs are prepared on the basis of a written contract. The technical assignment/specifications or other requirements of the employer usually form part of this contract.

3.4 Construction

The essential responsibilities of the employer, the contractor, the subcontractor and the designer

are outlined respectively in **2.1 The Employer**, **2.2 The Contractor**, **2.3 The Subcontractors** and **2.5 The Designer**.

Another participant with essential responsibilities is the consultant, who:

- assesses the compliance of investment projects and/or exercises construction supervision;
- carries out inspection and control of the construction products delivered and put into the construction;
- may perform: pre-investment studies, preparation of the design process and co-ordination of the construction process until the construction is commissioned, including control of the quantities, quality and compliance of the construction and installation works performed for the execution of the contracts.

When the consultant exercises construction supervision, it is responsible for:

- the lawful initiation of the construction;
- exercising control in respect of the completeness and the correct drawing up of the acts and protocols during construction;
- suspending construction that does not meet applicable legal requirements;
- not allowing any damage to third parties and properties as a result of the construction;
- exercising control in respect of the compliance with the applicable occupational health and safety regulations;
- notifying the competent authorities in case of a breach; and
- preparing a final report to the employer upon completion of the construction.

3.5 Site

Typically, the employer is responsible for the status of the construction site and for carrying out the relevant pre-design studies of the construction site.

In design-and-build contracts, these responsibilities may be shifted on a contractual basis to the contractor. Thus, any studies done in advance by the employer constitute part of the contract and the contractor is responsible for ensuring the compliance of the designs with such studies. The party responsible for preparing the designs shall ensure that the designs meet the requirements of environment conservation, biological diversity, cultural heritage and other laws.

Prior to the opening of the construction site, the employer is responsible for preparing a construction waste management plan (if required) and a health and safety plan.

The opening of the construction site is ascertained by a relevant protocol under Ordinance No 3.

3.6 Permits

All construction (except the simplest types of works) requires the issuance of a construction permit, prior to commencement. The issuance of the construction permit usually implies the preliminary approval of the designs for the construction project, and the completion of all of the necessary approval and co-ordination procedures and the obtaining of the necessary conformity assessment reports. Depending on the type of agreement between the parties, these can be either the employer's or contractor's responsibilities.

The construction permit is issued to the employer and the employer is responsible for obtaining it.

In some cases, the employer assigns to the contractor the procedure for obtaining the construction permit and/or the parties agree on specific rights, obligations and liability for default provisions with regard to obtaining the construction permit.

3.7 Maintenance

Until the handover and acceptance of the construction works, the contractor is responsible for their maintenance.

After completion of the construction but prior to its commissioning, a technical passport must be drawn up, detailing the basic characteristics of the construction, the means for its maintenance, the terms for carrying out relevant repair works and guidelines and instructions for its safe operation. The maintenance means entail the scheduling, implementation and/or documenting of:

- examinations, major renovation, reconstruction, repair and other changes;
- means for maintaining safe operation of the construction and a schedule for implementing emergency means;
- details and characteristics of the executed maintenance, remodelling, and reconstruction of the construction; and
- terms for performing major and current repairs to individual structures and elements of the construction.

The provisions of the technical passport are mandatory to the employer. In some large infrastructure projects, the maintenance of the construction is contractually assigned to a specialised maintenance company or an SPV.

The employer is responsible for maintaining the technical condition of the construction in accordance with the essential construction requirements and shall not allow or perform any changes to the construction which could lead to the deterioration of the designed levels of compliance.

3.8 Other Functions

It is not common in Bulgaria (excluding large infrastructure projects) for the employer to assign functions to the contractor other than the performance of the construction works (in contracts for construction) and the preparation of the designs (in design-and-build contracts).

A major exception is the concession for construction contracts, where the concessionaire (contractor) is assigned the performance of the construction works against the right of the contractor to operate the construction subject to assuming the operational risk.

3.9 Tests

Testing is not mandatory for all types of construction works.

In accordance with the provisions of the relevant agreement, tests are generally required for production facilities and other construction projects with a specific purpose. Where machines and equipment are installed as part of the construction works, they need to be tested individually.

The successful completion of the tests is the responsibility of the contractor.

The tests have to be successfully completed prior to the commissioning of the construction. If parts of the construction can be used independently, the construction contract may provide

that the tests for these parts can be completed prior to the full completion of the construction.

The successful completion of the tests is ascertained with the relevant protocols for testing.

3.10 Completion, Takeover and Delivery

Upon completion of the works, the executive documentation shall be prepared (reflecting the non-material deviations from the approved designs) and shall be certified by the relevant participants in the construction process, and shall be handed over to the authorities that have approved the designs.

Thereafter, an ascertainment act under Ordinance No 3, certifying that the construction is executed in accordance with the approved investment designs, the certified executive documentation and the material requirements for construction, shall be drawn up. Where tests were carried out, the protocols for testing shall also be attached to this protocol.

By virtue of law, this ascertainment act also serves as a protocol for acceptance of the construction works by the employer. The employer has the right to use the construction only after its commissioning with a use permit or commissioning certificate.

3.11 Defects and Defects Liability Period

The contractor bears liability for defects and warranty liability. The two types of liability are of different legal natures and they exist and are extinguished independently from one another.

Liability for Defects in Works

Visible defects

At acceptance, the employer shall diligently examine the works within due course and immediately make all objections for inaccurate

execution of the works. If no such objections are made, it is deemed that the works are accepted.

Hidden defects

In cases that the defects cannot be discovered within the course of an ordinary examination or defects appear later, the employer shall notify the contractor of the defects immediately upon their discovery. No additional notification shall be necessary if the contractor has known of the defects.

In case of visible or hidden defects, the employer has the right to request:

- remedying of the defects within a term prescribed by the employer, without payment;
- payment of the expenses necessary for the remedying; or
- respective reduction of the remuneration.

In case that the deviations from the assignment or the defects are irremediable and so material that the works are not fit for their agreed or ordinary purpose, the employer has the right to rescind the contract (see 9.6 Termination) and is entitled to compensation under the general rules.

The contractor remains liable to the employer for defects for a period of five years from the date of acceptance, after expiry of which term the above-mentioned rights of the employer are extinguished.

Warranty Liability of the Contractor and Warranty Terms

Warranty liability of the contractor is an obligation to ensure that for a certain period of time the construction and installation works, facilities and construction will retain their properties and qualities. Ordinance No 2 sets out minimum war-

warranty terms, during which the contractor bears warranty liability. The warranty period depends on the type of construction and ranges from two to 13 years. All warranty periods start to run as of the date of commissioning of the construction. In the construction contract the parties can agree to warranty periods longer, but not shorter, than those under Ordinance No 2.

In respect of liability for defects in design, see 3.3 Design, 7.5 Risk Sharing and 9.1 Remedies.

4. Price

4.1 Contract Price

The contract price is an essential element of the construction contract and can be determined using the following methods:

- lump price – the contractor is paid a fixed price or a fixed unit price with the option for cost increase, if agreed;
- cost plus – the contractor is reimbursed the actual costs incurred plus a percentage of those costs or a fixed fee; and
- measurement – in the bill of quantities, unit prices per square metre or for certain types of works are fixed and the total contract price is determined on completion of the works.

The contract price entails the amounts of all the direct costs plus profit.

Milestone payments are often used and are tied to reaching a certain milestone or completing a certain type of work. They are linked to the time periods (according to the programme) for reaching a certain stage or part of the works and form an appendix – an integral part of the contract.

4.2 Indexation

In recent years, indexation clauses have been increasingly used in privately commissioned construction contracts.

Usually, the contractor bears the risk of substantial increase of the price of material or labour used. In addition to indexation (insofar as applicable), as per COA, the contractor is entitled to an adjustment of the price if, during the term of the contract, the duly determined price for the material or labour is changed, notwithstanding that the price has been agreed in full.

In public procurements, the price of a public procurement contract (PPC) for construction can be amended in cases where the prices of essential goods, materials and services, which form the price of the contract, have been substantially increased because of inflation. The amendment is subject to the availability of financial resource and is done in accordance with a methodology, approved by the Council of Ministers.

Any amendment to the price shall be reflected in a relevant additional agreement (annex) to the PPC.

4.3 Payment

The payment schedule is subject to negotiation between the employer and the contractor and generally the price is divided into instalments, including: advance payment, one or more interim payments and final payment.

Usually, the contract provides for an advance payment, which is used by the contractor for covering the initial expenses necessary for the construction. It is usually made prior to the opening of the construction site and is conditional upon the provision by the contractor of a security in the form of a guarantee deposit,

retention money or a performance bank guarantee and the agreed insurances.

The largest portion of the contract price is paid in the form of one or more interim payments. Such payments are often conditional upon the reaching of a certain stage of the construction and acceptance by the employer of the relevant works completed up to that stage.

The final payment is usually made can upon completion of the works and their acceptance by the employer or upon commissioning.

The contractor can seek securitisation of its receivables – most commonly by a bank guarantee and less often by a promissory note.

Typical measures for managing late payment are compensations in the amount of the statutory interest for delay or liquidated damages. The contractor is also entitled to objection for non-performance of counter-obligation (see **9.5 Retention and Suspension Rights**), or rescindment of the contract (see **9.6 Termination**).

4.4 Invoicing

Invoicing conditions typically follow the agreed payment conditions, taking into account the provisions of the Value Added Tax Act. The invoicing of the interim payments usually follows the drawing-up of relevant ascertainment acts and protocols under Ordinance No 3 or the issuance of a relevant payment certificate, as the invoices need to be prepared in line with these documents.

5. Time

5.1 Planning and Programme

The time for completion, as well as any interim deadlines, are essential in the construction contract. Strict administrative regulation and the principles of documentation and supervision of the construction process imply the need for planning and preparation of a programme (or schedule).

The programme can be prepared by the employer or by the contractor on the basis of the design, the employer's requirements or the financing conditions. Once agreed between the parties it shall be an appendix to the contract.

Observing the time for completion and the programme are usually secured by liquidated damages for delayed performance, by linking the contractor's payments to the milestone under the programme, by objection of the employer for a breach of contract.

Adherence to the programme is controlled by the employer and is ascertained by the relevant acts and protocols in accordance with Ordinance No 3 and by bilaterally signed protocols.

5.2 Delays

The construction process entails the completion of multiple procedures, works and activities within multiple periods, all of which may be delayed.

Delay of the Contractor

Generally, the contractor is in delay if it fails (by reason for which the contractor is responsible), within the agreed time, to perform the works or to hand over the works, executed in accordance with the contract.

The remedies available to the employer in case of delay of the contractor are outlined in **5.3 Remedies in the Event of Delays**.

Delay of the Employer

The most common cases of delay of the employer are cases where, within the agreed time, the employer fails to:

- pay the due remuneration;
- accept the performed works, executed in accordance with the contract;
- provide the necessary designs, documents or materials;
- grant access to the construction site;
- provide the persons whose participation in the construction process is mandatory; and
- assist in drawing up the acts and protocols establishing the completion of certain works or stage.

The remedies available to the contractor in case of delay of the employer are, most commonly:

- right to seek payment of the agreed remuneration plus compensation for delay in the amount of the accrued statutory interest;
- right to liquidated damages; and
- right to rescind the contract (see **9.6 Termination**).

In case of delay by one of the parties, the other party shall serve a written notice, providing an appropriate time for performance. Many contracts provide for timely notifications to the other party of circumstances which could lead to delay. To avoid delays, periodic progress meetings and/or the submission of progress reports may be provided.

Delay by Reasons for Which the Party is Not Responsible

Generally, a party is not liable for delays by reason not attributable to the party's default: see **5.5 Force Majeure**, **5.6 Unforeseen Circumstances** and **9.6 Termination**.

Delays by reasons for which the contractor is not responsible have, as a consequence, an extension of time.

5.3 Remedies in the Event of Delays

By virtue of law, in cases of the contractor's delay, the employer is entitled to:

- effective performance of the agreed obligation plus compensation for delay;
- compensation for the non-performance of the obligation;
- authorisation by the court to carry out the agreed works at the expense of the contractor;
- rescind the contract if it becomes apparent that the contractor will not perform on time, in the agreed or due manner (see **9.6 Termination**); or
- rescind the contract under the general rules (see **9.6 Termination**).

Special contractual provisions relating to contract terminations are also commonly used.

Liquidated damages are another commonly used contractual remedy.

In cases where both parties are in delay and the counter obligations are not conditional upon one another, each of them is entitled to rescind the contract and no compensation is due.

5.4 Extension of Time

The contractor shall notify the employer of the reasons for an extension of time and the consequences thereof. In case of some of the grounds for extension of time which are due to the delay of the employer, the contractor also has the option of raising an objection for non-performance of counter obligation (see **9.5 Retention and Suspension Rights**).

Generally, the grounds for extension of time are:

- change of the investment intentions of the employer and award of new or additional works;
- delay of the employer (see **5.2 Delays**);
- reasons for which other participants in the construction are liable – the consultant, the supplier of machinery and equipment, the designer;
- force majeure (see **5.5 Force Majeure**);
- adverse geological conditions; or
- archaeological finds which could not have been foreseen.

Some of the above-mentioned grounds are also grounds for suspension of construction. In such instances, for the suspension of the construction, a relevant act under Ordinance No 3 shall be drawn up and signed, which proves both the existence of a circumstance which leads to extension of time and its duration. The existence of a force majeure event can be proven through a certificate of force majeure, which is issued by the Bulgarian Chamber of Commerce and Industry.

5.5 Force Majeure

Under Bulgarian law, force majeure is defined as an unforeseen or unavoidable event of extraordinary nature, which has occurred after the con-

clusion of the contract, is of a temporary nature and results in the impossibility of performance.

The Bulgarian legislation does not contain a list of events classified as force majeure. These generally include: natural disasters, state of war, labour strike, etc. The parties are entitled to specify events that they consider being or not being force majeure events.

The consequences of force majeure include:

- for the duration of the force majeure the performance of the obligations affected by the force majeure and their respective counter-obligations are suspended;
- the party who owes performance is exempt from liability for non-performance as a result of the force majeure and is not liable for damages. It shall not be exempt from performance if it has been in default before the occurrence of the force majeure event; and
- the debtor invoking the force majeure shall notify in writing the other party of the presence of the force majeure event. Otherwise, it owes compensation for damages to the other party.

If the force majeure lasts long enough so that one of the parties no longer has interest in the contract, this party is entitled to unilaterally terminate the contract (see **9.6 Termination**).

5.6 Unforeseen Circumstances

The PPA provides that “unforeseen circumstances” are circumstances that have occurred after the conclusion of the contract, could not have been foreseen taking due care, are not a result of an action or omission of the parties, but render impossible the performance of the obligations under the agreed conditions. The presence of unforeseen circumstances is one of the grounds

for amendment of the PPC, which is otherwise generally inadmissible.

The legally defined term “unforeseen circumstances” is applicable to PPC, but not to all construction contracts. However, based on the freedom of contract principle, the parties may contractually define what they would consider “unforeseen circumstances”.

5.7 Disruption

Bulgarian legislation does not acknowledge disruption in the meaning of disturbance, or change in the originally planned execution, which leads to lower efficiency in the execution, respective to costs associated with it. There are no established methods for disruption evaluation.

The principles of accurate performance and good faith, of co-operation between the parties, of sequency and conditionality of the counter obligations are applicable to the construction contracts which usually contain clauses for compliance with these principles and that neither party will prevent the other from accurate performance of its obligations.

6. Liability

6.1 Exclusion of Liability

Pursuant to the OCA, any provisions which limit or exclude in advance the debtor’s liability for gross negligence or wilful misconduct are considered invalid. Further, any exclusion of the liability of the parties for non-compliance with the statutory requirements would also be deemed invalid. Any exclusion or time limitation of the warranty liability of the contractor is invalid.

6.2 Wilful Misconduct and Gross Negligence

Both the concept of wilful misconduct and gross negligence exist in the Bulgarian legal system and are governed by mandatory provision of law as follows.

- In Bulgarian civil law, wilful misconduct is a form of fault, where the debtor has deliberately failed to perform its obligation.
- The term “negligence” is closely associated with the term “due care”. When performing its obligations under the contract, the party is under the obligation to exercise due care, acting with the necessary knowledge, skill, diligence, conscientiousness and professionalism. The party has acted with negligence if it has failed to exercise due care. “Gross negligence” is different from regular negligence in terms of its intensity: the debtor has acted with gross negligence if it has not exercised even the basic care to perform its obligation; has not exercised the care that even the most negligent person would have exercised in similar circumstances.

6.3 Limitation of Liability

In general, the Bulgarian law allows for certain limitations of liability, subject to the restrictions outlined in **6.1 Exclusion of Liability**.

Most commonly, the parties agree on capping the liquidated damages potentially due under the contract. However (if not agreed otherwise), if one of the parties suffers damages greater than the amount of the agreed liquidated damages, the injured party is entitled to seek compensation for the damages exceeding the amount of the liquidated damages, even if this is not expressly agreed in the contract.

7. Risk, Insurance and Securities

7.1 Indemnities

In addition to the insurances of the contractor (see 7.3 Insurance) and the remedies available in case of default, which include compensation in case of contract non-performance (see 9.1 Remedies) and based on the freedom of contract, the parties may provide for certain risks associated with the performance of the construction contract, in the occurrence of which one of the parties owes indemnity to the other. Such indemnity clauses most commonly refer to the risk of claims of third parties for protection of intellectual property rights or tort claims of third parties that have suffered personal injury or property damage in connection with the construction works.

7.2 Guarantees

With the exceptions mentioned below, in Bulgaria the parties have the freedom of contract to negotiate the type of guarantees which each of them should provide and the manner of the guarantees' provision.

Guarantees of the Contractor

In private projects, at the tender stage, the participants may be required to provide a deposit or a bank guarantee. These serve as a collateral to the employer in the event that the participant in the tender procedure is chosen as contractor, but refuses to conclude the construction contract.

The provision of the advance payment is sometimes subject to the granting of a bank guarantee or a guarantee deposit by the contractor in order to ensure that the employer would be able to recover the amount paid in advance, should the contractor fail to fulfil its obligations.

Performance guarantees, corporate guarantee, guarantee deposits, and retention money are other commonly used forms of guarantee in Bulgaria.

Guarantees of the Employer

The payment obligations of the employer are most often secured by means of bank guarantees, and less often by promissory notes.

Special Provisions

As per the special provisions of the PPA, a guarantee shall be provided in the form of a cash deposit, bank guarantee or insurance securing performance by covering the liability of the contractor. An insurance can be provided only in a case where the amount of the advance payment or performance security is up to BGN500,000. The amount of any performance guarantee shall not exceed 10% of the contract value. A guarantee securing the advance payment shall be in an amount of the advance payments.

7.3 Insurance

By virtue of law, the contractor, the designer, the person performing technical supervision on "Structural", the person exercising construction supervision, and the consultant are required to obtain a professional liability insurance.

This insurance generally covers the damages caused to other participants in the construction and/or third parties as a result of unlawful acts or omissions of the insured person during or in connection with the performance of its obligations.

The following risks are not covered by the professional liability insurance:

- war or terrorism;
- direct or indirect effect of ionising radiation or radiation pollution;

- improper use of flammable or exploding materials;
- penalties, sanctions and liquidated damages due; and
- damages caused to own workers and/or employees.

The parties are free to negotiate other types of insurances such as: insurance of the contractor covering the liability with regard to the specific construction site, additional insurance covering the material damages on the construction, the materials, the on-site construction machinery and equipment during the term of construction (if these are paid by the employer or are its property).

The contractor shall also furnish a work accident insurance.

Construction All Risk (CAR) insurances are also commonly accepted.

7.4 Insolvency

In construction contracts it is generally agreed that if insolvency proceedings are opened against one of the parties, or one of the parties is declared insolvent, the other party has the right to rescind the contract.

In the event that the contractor is declared insolvent, it shall be de-registered from the Central Professional Register of the Builder.

The following (without limitation) provisions may also have a reflection on the relations between the parties in case of insolvency.

- As of the date of the court decision for the opening of insolvency proceedings, all non-monetary obligations are converted to monetary ones on their market values. As of entry

of the decision in the commercial register, all payments to the debtor must be accepted by the insolvency practitioner.

- If the contract is not performed (in full or in part), the insolvency practitioner is entitled to terminate the contract with 15 days' notice. The counterparty is also entitled to ask the insolvency practitioner to state whether they terminate the contract or not. If the insolvency practitioner does not respond within a 15-day term, it is deemed that the contract is terminated.
- On the date of the court decision declaring the debtor insolvent, all obligations of the debtor become due.

7.5 Risk Sharing

Aside from the contracts under FIDIC forms of contract, the risk-sharing model is not a common practice in Bulgaria. However, the Bulgarian laws contain multiple provisions relating to risk allocation, such as:

- the risk for adverse geological conditions, archaeological finds which could not have been foreseen, lies with the employer as owner of the land (or person having the right to construct on the land);
- the contractor bears the risk of subsequent objective impossibility for performance of the contract. If part of the works has been performed and can be useful to the employer, the contractor is entitled to a relevant portion of the agreed remuneration;
- the risk of impossibility of performance due to inappropriateness of the designs or materials provided by the employer lies with the employer, if the contractor has timely notified the employer ;
- the risk of accidental loss or damage of the construction works is borne by the contrac-

tor until the acceptance of the construction works;

- the risk of accidental loss or damage of the materials to be used in the construction lies with the party that has provided the materials, unless the other party is in delay; and
- generally, in case of delay by one of the parties, the risk is transferred to that party. A similar rule also applies to cases of force majeure.

A risk, which by virtue of law is borne by one of the parties, can be shifted to the other party based on the principle of freedom of contract. In cases where the risk is transferred from the employer to the contractor, this is generally associated with an increase of the contract price (particularly in cases where a lump-sum price model is used). The inclusion of provisions, regulating the payment of contingencies (up to a certain amount) or reimbursement of certain costs, outside of the contract price is another commonly used method of pricing the risks shared between the parties.

8. Contract Administration and Claims

8.1 Personnel

Generally, it is agreed that the contractor shall ensure the necessary personnel are available, and that all employees engaged in the construction have the required professional qualification, knowledge and experience. In design-and-build contracts, the contractor shall ensure that the engineers and/or architects charged with the preparation of the designs have the required designer's capacity.

It is usually agreed that the contractor is under the obligation to comply with the relevant occu-

pational health and safety, traffic safety, fire protection, sanitary and hygiene requirements, including to provide the relevant protective clothing, equipment and specific instructions, where the nature of the works so requires.

In large construction projects the tender documentation often requires that the participant designates key experts with specific areas of expertise.

8.2 Subcontracting

Unless agreed otherwise, the contractor has the right to subcontract certain types of construction works or parts (stages) of the construction.

Typically agreed contractual limitations to subcontracting are:

- obligation of the contractor to notify the employer in advance about the subcontractor and the scope of works which are to be subcontracted. Subcontracting may be subject to the preliminary written approval of the employer; and
- prohibition of the contractor to subcontract the entire scope of activities assigned to it under the construction contract to third parties.

In public procurements the employer may specify that a portion of the procurement (up to 30% of the value) shall be done by subcontractors. The contractors may offer involvement of subcontractors for a larger portion. The contractors are required to indicate in advance the subcontractors that will be used. Specific conditions for the use of subcontractors in concession construction contracts are contained in the Concessions Act.

8.3 Intellectual Property

All approved architectural designs, approved urban development designs, maps, schematics, plans and others relating to architecture and spatial development are considered objects of copyright.

The natural person who has created the designs is their author and has the title of all authorship rights.

The following contractual provisions are often included in the contracts.

- In contracts for construction – guarantees by the employer that it has the necessary rights and/or that it will procure the necessary authorisations for the use of the designs by the contractor for the execution of the construction works and the employer will indemnify and hold the contractor harmless against any claims of third parties (in particular the author of the designs) relating to the use of the designs.
- In design-and-build contracts – that the copyright over all designs in any form shall pass to the employer without further payment by the employer.

9. Remedies and Damages

9.1 Remedies

In the event of breach of the construction contract, the affected party can resort to the following remedies.

Remedies available to both parties:

- right to seek effective performance of the agreed obligation with compensation for delay;

- compensation for the non-performance of the obligation;
- objection non-performance of counter-obligation (see **9.5 Retention and Suspension Rights**);
- liquidated damages;
- right to rescind the contract under the general rules and to seek compensation for the damages caused as a result of the contract rescindment (see **9.6 Termination**); and
- right to satisfy its payment claim through the guarantees provided.

Remedies available to the employer:

- authorisation by the court to carry out the agreed works at the expense of the debtor;
- right to rescind the contract if it becomes apparent that the contractor will not perform on time, in the agreed or due manner (see **9.6 Termination**); and
- in case of defects the employer has the rights under the first heading in **3.11 Defects and Defects Liability Period**, including the right to rescind the contract (see **9.6 Termination**).

Remedies available to the contractor:

- claim for payment of the due contract price or part of it; and
- compensation for delayed payment in the amount of the accrued statutory interest.

The compensations under the first two bullet points above cover incurred loss and the loss of profit to the extent the same are a direct and immediate consequence of the contract non-performance and could have been foreseen upon the obligation arising. Where a party seeks compensation for loss of profit as a result of delay in the construction, the obtaining of such profit needs to be certain, and such certainty is not presumed.

9.2 Restricting Remedies

Although the parties may agree on restricting the remedies available, they cannot agree to waiving, limiting or excluding:

- the parties' liability for wilful misconduct or gross negligence (see 6.1 Exclusion of Liability); and
- the right to contract rescindment in the event of contract non-performance.

The parties cannot agree on waiving in advance or excluding the right to lodge a claim in the event of breach of contract.

The parties may agree on:

- capping the liquidated damages potentially due under the contract;
- a sole remedy clause (see 9.3 Sole Remedy Clauses);
- setting out procedures for the due exercise of certain rights under the contract; and
- provision limiting the due compensation for breach of contract only to those damages that are not covered by the relevant insurance.

With the exception of the exclusive liquidated damages clause, the parties may not limit the applicability of types of remedies available by virtue of law.

9.3 Sole Remedy Clauses

The use of sole remedy clauses in construction contracts is not a common practice in Bulgaria. The parties can agree on an exclusive liquidated damages clause, which provides that in the event of breach of contract the defaulting party's liability will be covered by the exclusive liquidated damages and that it will not owe any other compensation (unless the damages have

been caused as a result of wilful misconduct or gross negligence, in which case the defaulting party shall owe compensation).

9.4 Excluded Damages

The liability of the parties is limited to the incurred loss and the loss of profit to the extent the same are a direct and immediate consequence of the contract non-performance and could have been foreseen upon the arising of the obligation. If the defaulting party has acted in bad faith, it is liable for all direct and immediate damages (regardless of whether they could have been foreseen or not).

The parties are not liable for indirect, non-consequential damages (ie, in cases where the cause-and-effect link between the contract breach and the damages has been interrupted).

Excluding certain forms of damages on a contractual basis is not a common practice in Bulgaria.

9.5 Retention and Suspension Rights

Retention rights (on real estate and commercial liens) are not applicable to the construction contract.

Suspension rights are usually used in construction contracts. The general applicable rule is the objection for non-performance of counter-obligation set out in the OCA. By exercising such objection, either party to the contract may refuse to perform its enforceable obligation until the other party has performed its counter-obligation. The contractor may suspend the works until due payment is performed or until the necessary assistance or provision of construction machinery or materials (if provided by the employer) is received. Accordingly, the employer

may suspend the due payments in the event of non-performance of the works due.

The SDA contains a special rule enabling the employer to suspend all payments due in the event of failure by the contractor to maintain professional liability insurance.

9.6 Termination

Termination herein means any termination of the contractual relationship.

In Respect of a Construction Contract in the Private Sector

General grounds:

- by accurate performance of the obligations of the parties;
- by mutual written consent;
- in case of complete subsequent objective impossibility not due to the fault of the debtor – termination of the contract by virtue of law. In such cases the contractor is not entitled to remuneration. However, the contractor is entitled to remuneration for the part of the work that has been executed and may be useful to the employer;
- in the event of partial subsequent objective impossibility of performance of the contractor's obligation, the employer shall be entitled to demand a proportionate reduction of the price or to ask the court to rescind the contract if the employer no longer has interest in partial performance;
- in the event of force majeure – termination henceforth by a unilateral written statement of the party having lost interest in performance;
- in the case of business frustration (as defined in 3.2 Variations) – by the court, on the basis of a claim of one of the parties; and
- rescindment due to a substantial default of one of the parties, by written notice by

the non-breaching party to the other party, granting an additional appropriate term for performance, with a warning that the contract will be deemed rescinded upon expiry of the term. Granting of additional term is not required if the performance has become impossible in whole or in part, if by reason of delay of the debtor it has become useless. According to the case law, the rescindment of a construction contract may also be done by a court claim for damages, liquidated damages or repayment of the remuneration under the rescinded contract. Rescindment of construction contracts where real property rights are transferred or established shall be made by court decision. The right to rescind the contract shall be time-barred for five years.

Special grounds for termination of construction contract:

- termination by the contractor by written statement to the employer if the employer has provided a design or material inappropriate for the execution of the work, the contractor has promptly notified and requested the employer to make changes or supply suitable material, and the employer has failed to make the requested changes or supply suitable material. The contractor is entitled to remuneration if it has notified the employer thereof in a timely manner;
- termination by the employer in the presence of reasonable cause. Termination of the contract on this ground is permissible where performance has begun but not has been completed and accepted;
- right of the employer to rescind the contract by unilateral written statement if it becomes apparent that the contractor will not perform on time, in the agreed or due manner. This assessment is made on a case-by-case basis

depending on the type and specifics of the construction. The employer is entitled to compensation under the general rules; and

- right of the employer to rescind the contract by unilateral written statement in the presence of material and irremediable defects which render the work unfit for the ordinary or agreed purpose. The right shall be exercised within a limitation period of five years from acceptance – for visible defects and from their discovery – or for hidden defects. The employer shall be entitled to compensation under the general rules.

Special grounds for termination are provided for in the PPA and the Concessions Act in respect of PPC and concession contracts, respectively.

Special grounds for termination are provided for in respect of works awarded by way of a works concession.

10. Dispute Resolution

10.1 Regular Dispute Resolution

Unless the parties have agreed otherwise, construction disputes are resolved under claim proceedings before a court under the general rules of the CCP.

The courts of first instance are:

- the regional courts on disputes with a value of the claim up to BGN25,000; and
- the district courts – for claims over BGN25 000.

Unless agreed otherwise, the local jurisdiction of the courts is determined by the seat and/or permanent address of the defendant.

The first instance judgment is subject to appeal before the relevant district court or the relevant court of appeal, and in the presence of the grounds for cassation appeal – before the Supreme Court of Cassation of the Republic of Bulgaria.

10.2 Alternative Dispute Resolution

Arbitration is the most preferred alternative means of resolving construction disputes in the private sector.

Disputes relating to contracts awarded under the PPA are also subject to arbitration.

Arbitration is governed by the ICAA, which establishes mandatory prerequisites for arbitration.

The parties usually specify in the contract a standing institutional arbitration which shall solve all disputes that may arise between the parties. The arbitration agreement shall be in a written form. The arbitral award is final, has the force of *res judicata* and is enforceable. It is subject to annulment by bringing a claim for annulment on the grounds exhaustively set out in the ICAA before the Supreme Court of Cassation, which cannot consider the merits of the dispute. Foreign arbitral awards and agreements are subject to recognition and admission for enforcement in the Republic of Bulgaria, following a three-instances judicial proceeding.

Mediation is another method for dispute resolution in construction expressly regulated by the MA.

The settlement reached on a legal dispute in the mediation proceedings has the force of a court settlement and is subject to the approval of the regional courts in the country.

Trends and Developments

Contributed by:

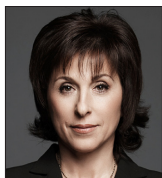
Victoria Penkova and Yavor Tankov

Penkova & Partners Law Firm

Penkova & Partners Law Firm is a boutique firm with a focus on business law. It was established 2000 and is located in Sofia. The team is comprised of five lawyers, two paralegals and two external legal consultants. For more than 20 years, the firm has acquired considerable experience in the area of construction law and its related fields: urban planning, real estate and property law, construction contracting and subcontracting, financing and securitisation agreements, public procurement procedures,

as well as contentious matters. The law firm provides legal advice in all stages of construction: from the initiation of the urban development procedures until the commissioning of the construction. The firm has consulted clients on infrastructure (including regulated under FIDIC forms of contract) projects of national significance, railway projects, and some of the largest prospective mixed-use residential and office projects in the country.

Authors



Victoria Penkova is the managing partner at Penkova & Partners, and has been practising law since 1990. She has extensive experience in the fields of construction, real

estate, contract and commercial law and M&A. Victoria provides legal consultations in all phases of construction and represents clients in court and arbitration proceedings. Qualified in practical use of FIDIC conditions of contract and management of contract claims and resolution of disputes, she is a chair of the Bulgarian Society of Construction Law and is included in the list of adjudicators at the Bulgarian Association of Architects and Consulting Engineers. Victoria is fluent in English.



Yavor Tankov has been a member of Sofia Bar since 2018 and joined Penkova & Partners in 2019. His practice is focused predominantly on the fields of contract and commercial law

while he also has experience in construction and public procurement matters. Yavor provides legal consultancy and procedural representation on multiple matters to various clients, including a contractor under a railroad infrastructure project. He has completed an introductory course on the practical use of FIDIC Conditions of Contract and a course on matters of arbitration at the Bulgarian Chamber of Commerce and Industry. Yavor is fluent in English and Spanish.

Penkova&Partners Law Firm

9 Hristo Belchev Street
Floor 2
Sofia
1000
Bulgaria

Tel: +359 2986 79 07
Email: vpenkova@penkova-partners.com
Web: www.penkova-partners.com



In the wake of the COVID-19 pandemic, just as the construction sector had returned to its upward trend, the war in Ukraine caused disruptions in the supply chains and – consequently – substantial increases in the costs of some essential goods and materials for construction. In turn, this became a cause for serious concern for contractors, who, in general, bear the risk on substantial increase in the price of materials, goods and labour.

As a response, in 2022, changes were made to the Public Procurements Act (PPA), which allowed for indexation of the price of public procurement contracts for construction.

Indexation of the Prices of Public Procurement Contracts for Construction

In the second half of 2022, changes to the Public Procurements Act (PPA) were made providing that the price under a public procurement contract can be amended, where as a result of inflation the prices of essential goods and materials, which form the price of the contract, are substantially increased. Pursuant to the aforementioned amendments, the Council of Ministers adopted a Methodology (the “Methodology”), detailing the procedure and formula for indexation of the prices under public procurement contracts for construction.

However, the practical application of the Methodology showed that the legal framework at the time limited, or in some cases, disallowed some contractors from benefiting from indexation. Another issue was that the initial version of the Methodology provided that subject to indexation were the prices of works, which have been accepted by the employer. This meant that some contractors were put in a disadvantageous position, as the entitlement to apply for indexation was conditional upon the specific terms of the contracts regulating the acceptance of the works.

Thus, in 2023, another set of amendments to the PPA and the Methodology were made further to the feedback from the construction sector, allowing contractors to apply for indexation for works that have been completed (regardless of whether or not they have been accepted by the employer). Some limitations to the total value of the price increase (indexation) for which the contractor could apply, were also repealed.

The Methodology aims to compensate the substantial increase of the costs of essential goods and materials, included in the formation of the price of a public procurement contract for construction. The Methodology, however, does not regulate an increase of the costs of services

included in the price of a public procurement contract.

Pursuant to the Methodology, the prices of construction and installation works completed after 30 June 2021 shall be subject to indexation.

The indexation is done in accordance with a formula, taking into account:

- the “weight” of the building materials in the calculation of the production price in different types of constructions. The weight of the building materials ranges from 52% to 67%; and
- the tri-monthly producer price indexes on the domestic or international market of building materials, as published by the Bulgarian National Statistical Institute or EUROSTAT.

For the purposes of indexation, the parties to the construction contract shall draw up and sign tri-monthly reports, specifying the type, quantity and value of the construction and installation works during the relevant trimester.

At the time of the initial adoption of the Methodology (2022), the PPA provided that the increase (or the total value of all increases) of the price of a public procurement contract due to unforeseen circumstances cannot exceed 50% of the value of the main contract. That meant that some contractors could not benefit (fully, or some contractors at all) from the indexation, as the price of their construction contracts had already been amended on another grounds. In 2023, amendments to the PPA were made, providing that the limitation whereby the price of a public procurement contract due to unforeseen circumstances cannot exceed 50%, does not apply to the cases of amendments as a result of indexation. However, it was also provided that

where the price of the public procurement contract is adjusted due to indexation, the increase (or the total value of all increases) of the contract price due to indexation cannot exceed 50% of the value of the main contract.

Other Amendments to Public Procurement Act

In October and December 2023, other amendments to the PPA were made, introducing changes related to:

- bringing the Bulgarian PPA in line with EU legislation;
- implementation of commitments under the National Recovery and Resilience Plan; and
- improving the legal regulation in view of the problems identified in the practice of contracting authorities.

Changes have been made to the maximum amount of the performance guarantee, which may not exceed 10% of the contract value, and the requirement to provide a guarantee for the full amount of the funds advanced.

Amendments to the PPA were made with regard to contracts for which financing has not been secured at the opening of the procedure and the contracting authority has disclosed this circumstance. In accordance with the amendments, in such instances the performance of the contract shall commence after confirmation by the contracting authority of the secured financing and the provision by the contractor of the relevant performance guarantee. Failure to submit the performance guarantee within the time limit specified by the contracting authority, without objective reasons, shall lead to termination of the contract by the contracting authority. In the event that, after a period of three months from the date of conclusion of the contract, financing

has not been provided, either party may request termination of the contract without notice. If financing has not been provided after a period of ten months from the date of conclusion of the contract, the contract shall be considered terminated by virtue of the law.

Furthermore, multiple bills for adoption or amendment to essential laws in the construction sector were submitted. These bills are in performance of the measures provided under the National Recovery and Resilience Plan of the Republic of Bulgaria, with the aim of improving the regional development and the business environment in the country.

Digitalisation of the Construction Sector

The digitalisation of the construction sector is recognised as crucial for meeting the goals of the European Green Deal, such as enhancing energy efficiency in construction material production and providing comprehensive product information through electronic passports for both products and buildings. According to the strategic plan for “Digital Transformation of Bulgaria from 2020 to 2030”, the digital shift of the construction industry aims to implement circular economy principles, sustainable building practices, energy efficiency and carbon footprint minimisation. Additionally, digitalisation is a tool for achieving a more balanced energy landscape by integrating renewable energy sources and smart grid technologies to regulate building energy usage, ultimately reducing greenhouse gas emissions.

To that end and in performance of the National Recovery and Resilience Plan 2022–2026, the Ministry of Regional Development and Public Works is preparing:

- a project for the creation of a “Unified Information System for Spatial Planning, Investment Design and Construction Permitting”; and
- project “Support of a pilot phase for the introduction of Building Information Modelling (BIM) in investment design and construction as a basis for digital reform of the construction sector in Bulgaria”.

In 2023, the Bulgarian government developed and adopted a National Strategy for the Transformation of the Bulgarian Construction Sector and a roadmap for its implementation. The Strategy provides for a digital transformation of the construction sector by 2030 through:

- creation of conditions for effective electronic administrative services in the investment process; and
- optimising the design process, improving the quality of construction, protecting the environment by introducing level two of BIM in investment design and construction.

Creation of conditions for effective electronic administrative services in the investment process

The improvement of the efficiency of administrative services requires the creation of the necessary regulatory conditions and IT infrastructure for the provision of electronic administrative services in spatial planning, investment design and construction permitting by setting up a unified public register for spatial planning, investment design and construction permitting (a “unified public register”) and a unified information system for spatial planning, investment design and construction permitting (a “unified information system”); digitalisation of existing spatial plans and integration into a common spatial data base.

The establishment of a unified public register on the website of the Ministry of Regional Development and Public Works was introduced by an amendment to the Spatial Development Act of February 2021. It is provided that this register shall bring together the various administrative acts issued pursuant to the Spatial Development Act. The conditions and procedure for publishing and keeping up to date the information in the register shall be determined by a regulation of the Council of Ministers, which had not been adopted as at 18 April 2024, and the unified public register had not been created.

The project for the creation of the unified information system, which intended to manage the processes of application, electronic signing, co-ordination, approval and delivery of the final administrative act and to provide the opportunity for submission and approval of draft development plans and investment designs is included in the National Recovery and Resilience Plan. As at 18 April 2024, the conceptual model for the creation of the system had been adopted.

An amendment to the Spatial Development Act provided for the development of the specialised spatial data information systems of the Geodesy, Cartography and Cadastre Agency, including the establishment of the Spatial planning portal, as a central, web-based information system that ensures the publication of draft spatial plans, their amendments and plans that have entered into force. The regulation that shall govern the terms and conditions for the publication of acts and documents on the portal had not been adopted as at 18 April 2024.

Another objective aimed at the creation of conditions of effective electronic administrative services is the update and upgrade of the Register of Landslide Areas on the Territory of the Repub-

lic of Bulgaria with a Register of Areas with Abrasion and Erosion Processes on the Black Sea and Danube Coasts.

Implementation of level two of BIM in investment design and construction

The use of BIM in the survey, design and construction process has been promoted by the Bulgarian government to optimise design, protect the environment, improve the quality of construction, modernise the construction sector and to reduce costs. The introduction of BIM as part of the digital reform of the construction sector is in its initial phase.

Preparation of amendments to acts and regulations related to the digital reform of the construction sector

In March 2024, a bill for amendment and supplementation of the Spatial Development Act was submitted to the Bulgarian Parliament for consideration.

The purpose of the proposed amendments is to:

- accelerate and facilitate the process of permitting the preparation of development plans, detailed development plans and their amendments, approval of investment designs and their substantial amendments during construction, issuance of building permits and orders for their supplementation, preparation, certification and keeping of as-built records; and
- to overcome the lag of the regulatory framework in this area and to create the necessary conditions for functioning of the unified public register and the unified information system.

At the end of March 2024, and in continuation of the measures taken in connection with the digitalisation of the construction sector, the Min-

istry of Regional Development and Public Works has submitted for consideration a bill for amendment and supplementation to the Cadastre and Property Register Act (the CPRA), with the aim to relieve the administrative burden for citizens and businesses. The main objective of the bill is to introduce a new approach to the provision of services with cadastral, geodetic and specialised data and to create a new legal basis for the development of specialised spatial data information systems.

Amendments to the laws and regulations related to the digitalisation of the construction sector, as well as the creation of relevant regulations to govern the operation and maintenance of the relevant registers and information systems are expected from the construction sector and stakeholders, which require the relevant amendments to the legal framework to achieve a precise legal regulation, carried out in compliance with the applicable special provisions of law and securing access to the relevant information systems.

New Act to Allow for Construction of Offshore Wind Farms in Bulgaria

In December 2023, a bill on the Renewable Energy in Marine Spaces was submitted to the Bulgarian Parliament for consideration. The purpose of the bill is to regulate the procedures and principles for planning, construction, operation and removal (at the end of their life cycle) of electrical power plants in the marine spaces of Bulgaria.

In accordance with the bill, the Minister of Energy shall assign the preparation of a Plan for Development of Marine Electrical Energy Capacities. The plan shall specify the priority zones for construction and operation of marine electrical energy capacities (offshore wind farms). The plan

shall also provide for the initiation of concession procedures for wind farms with a capacity of not less than 1 GW until 2027 and for not less than new 2 GW for the period 2027–2030. The provisions of the plan shall also guarantee a constant increase in the installed capacities.

The bill provides that the right to construct and operate an offshore wind farm in a priority zone is to be granted on the basis of a concession contract.

On the other hand, the right to develop offshore wind farms in non-priority zones is to be done on the basis of a special permit, allowing its title to carry out all necessary pre-design studies, place temporary facilities in the provided area for carrying out the studies and be granted a concession-by-right for construction and operation of an offshore wind farm.

As at the date of writing, the bill has been accepted by the Bulgarian Parliament at first reading.

Amendments to the Cultural Heritage Act to Simplify Administrative Procedures and to Ensure Better Protection of Cultural Heritage

In March 2024, a bill of amendment and supplementation of the Cultural Heritage Act was submitted to the Bulgarian Parliament for consideration. The World Heritage Center has drawn the attention of the Bulgarian state to the need to include in the national regulatory framework texts on the assessment of the impact on cultural heritage, as well as other texts related to the protection of world heritage sites.

On the other hand, the aim of the amendments to the Cultural Heritage Act is to ease investors, designers and contractors, by optimising and improving the procedures for co-ordination of investment designs and requests for interven-

tions in protected territories for the protection of cultural heritage.

The purposes outlined above are to be achieved by the following amendments proposed by the bill.

- Two new activities of the National Immovable Cultural Heritage Institute for (NICHII) are introduced – monitoring of the condition of the immovable cultural heritage (ICH) through systematic observations as well as preparation of annual operational programmes.
- The powers and responsibilities of the authorities entrusted with the protection of cultural heritage are restructured, in order to achieve a more complete implementation of their activities in compliance with the principles and terms established by law.
- The co-ordination procedures established by law are simplified, and the terms for co-ordination are reduced by half.
- A new detailed regulation is introduced for the identification of the ICH.
- A new regime of preventive protection is established with the aim to prevent the possibility of damaging or destroying an object in the period between the beginning of its examination and its declaration as an ICH.

The Bulgarian Construction Sector Overcomes the New Challenges Placed Before the Industry

In accordance with the annual economic report of the construction sector for 2023, prepared by the Bulgarian Construction Chamber, the construction sector marked growth in the total monetary value of construction (building and engineering construction), the total number of construction permits issued, the number of PPC and the number of constructions started.

The Economic Policy Institute Forecasts Overall Growth in the Construction Sector for 2024

According to published information, the civil and non-residential construction segments in Bulgaria are expected to grow by 2025. On the other hand, the residential construction sector enters a period for which a zero or negligible growth is forecast.

CANADA

Law and Practice

Contributed by:

Bruce Reynolds and Sharon Vogel

Singleton Urquhart Reynolds Vogel LLP



Contents

1. General p.117

- 1.1 Governing Law p.117
- 1.2 Standard Contracts p.118

2. Parties p.118

- 2.1 The Employer p.118
- 2.2 The Contractor p.119
- 2.3 The Subcontractors p.120
- 2.4 The Financiers p.120
- 2.5 The Designer p.121

3. Works p.121

- 3.1 Scope p.121
- 3.2 Variations p.121
- 3.3 Design p.122
- 3.4 Construction p.122
- 3.5 Site p.122
- 3.6 Permits p.123
- 3.7 Maintenance p.123
- 3.8 Other Functions p.123
- 3.9 Tests p.123
- 3.10 Completion, Takeover and Delivery p.124
- 3.11 Defects and Defects Liability Period p.124

4. Price p.124

- 4.1 Contract Price p.124
- 4.2 Indexation p.125
- 4.3 Payment p.125
- 4.4 Invoicing p.126

5. Time p.126

- 5.1 Planning and Programme p.126
- 5.2 Delays p.126
- 5.3 Remedies in the Event of Delays p.127
- 5.4 Extension of Time p.127
- 5.5 Force Majeure p.128
- 5.6 Unforeseen Circumstances p.128
- 5.7 Disruption p.128

6. Liability p.129

- 6.1 Exclusion of Liability p.129
- 6.2 Wilful Misconduct and Gross Negligence p.129
- 6.3 Limitation of Liability p.129

7. Risk, Insurance and Securities p.130

- 7.1 Indemnities p.130
- 7.2 Guarantees p.130
- 7.3 Insurance p.130
- 7.4 Insolvency p.130
- 7.5 Risk Sharing p.131

8. Contract Administration and Claims p.131

- 8.1 Personnel p.131
- 8.2 Subcontracting p.131
- 8.3 Intellectual Property p.132

9. Remedies and Damages p.132

- 9.1 Remedies p.132
- 9.2 Restricting Remedies p.132
- 9.3 Sole Remedy Clauses p.132
- 9.4 Excluded Damages p.133
- 9.5 Retention and Suspension Rights p.133
- 9.6 Termination p.133

10. Dispute Resolution p.134

- 10.1 Regular Dispute Resolution p.134
- 10.2 Alternative Dispute Resolution p.134

Singleton Urquhart Reynolds Vogel LLP is recognised nationally and internationally as a leader in construction and infrastructure law, with offices in Vancouver and Toronto. Founded in 1982 on a construction litigation platform, the firm continues to draw a large volume of assignments related to the construction and infrastructure industry, an industry in which the lawyers at the firm are both highly skilled and experienced. While the core of the business is rooted in con-

struction and infrastructure, the firm also offers clients an extensive range of legal services in the fields of commercial litigation, professional liability, product liability, corporate commercial law, commercial real estate, workplace law and business immigration, along with other, more specialised areas of focus.

Many thanks to Nicholas Reynolds and Natasha Rodrigues for their contributions to this chapter.

Authors



Bruce Reynolds is co-managing partner and co-chair of Singleton Urquhart Reynolds Vogel LLP's international construction projects group. He specialises in the resolution of

construction and insurance claims, liens, surety bond claims, product liability issues, and architects' and engineers' errors and omissions issues. In addition, he advises clients on construction projects in Canada, the United States and overseas. Bruce has a stellar reputation in the construction industry for settling disputes and drafting and negotiating contracts. Together with his colleague, Sharon Vogel, he has played a significant role in helping the Ontario government to modernise the province's construction law and shape the Construction Act.



Sharon Vogel is a partner at Singleton Urquhart Reynolds Vogel LLP and co-chairs the firm's construction and infrastructure practice group. Her expertise includes

negotiation, mediation, arbitration and litigation of construction disputes, including construction liens, breach of contract, delays, surety bonds, construction insurance, and architects' and engineers' errors and omissions. Sharon is recognised for her success at settling disputes relating to large-scale infrastructure, industrial and commercial projects. She is certified as a specialist in construction law by the Law Society of Ontario and is a fellow of the Canadian and American Colleges of Construction Lawyers and the Chartered Institute of Arbitrators.

Singleton Urquhart Reynolds Vogel LLP

150 King Street West
Suite 2512
PO Box 24
Toronto
ON M5H 1J9
Canada

Tel: +1 416 585 8601
Fax: +1 416 585 9458
Email: breynolds@singleton.com
svogel@singleton.com
Web: www.singleton.com



1. General

1.1 Governing Law

Canada is a federation, with a single national government as well as ten provincial and three territorial governments. The province of Quebec is a civil law jurisdiction, as reflected by the Civil Code of Quebec, while the other provinces and territories are common law jurisdictions. Under the Constitution Act, 1867, which allocates jurisdiction by subject matter between the federal government and the provinces, in general terms, the law of contract is allocated to the provinces and territories.

As noted, the principal laws governing construction contracts in Canada are rooted in Canadian common law outside of Quebec, and in civil law within the province of Quebec. While Canada's two legal frameworks differ in certain important particulars, many of the practical remedies afforded to parties under both systems are not dissimilar in relation to construction contracts.

Freedom of Contract

A fundamental principle of the Canadian laws governing construction contracts is freedom of contract, which is generally strongly supported by Canadian courts. As such, subject to some exceptions such as the duty of honest contractual performance and the duty to exercise a contractual discretion reasonably, Canadian courts generally tend to avoid implying or imposing contractual terms into agreements (especially where a contract contains an entire agreement clause, which is common in construction contracts).

Statutory Lien Legislation

Another central feature of the law governing construction contracts in Canada is the use of statutory lien legislation within the common law provinces and territories (and the broadly related legal hypothec in Quebec). Liens provide a person who supplies services or materials to an improvement with the right to place a charge on the improved premises. Liens, which do not exist at common law in Canada, are established pursuant to statutory regimes that vary, as between

various provincial and territorial regimes, and, generally speaking, apply notwithstanding any agreement to the contrary.

1.2 Standard Contracts

Standard form construction contracts are widely used in Canada. In particular, the Canadian Construction Documents Committee's (CCDC) Contract Forms are a suite of standard form contracts which are widely used in both the private and broader public sectors and are developed through a consultation process involving representation from various construction sector stakeholder groups. The CCDC Stipulated Price Contract (CCDC 2), which forms part of this suite of contracts, is one of the most commonly used standard forms in the country and was last updated in 2020. The CCDC Service Contract (CCDC 31), which is commonly used as a service contract as between an owner and its consultant, was also updated in 2020. More recently, the CCDC Unit Price Contract (CCDC 4) was updated in 2023.

The Canadian Construction Association (CCA) also publishes standard form subcontracts, which are also widely used and which are updated intermittently (for example, the CCA released an updated standard form stipulated price subcontract in 2021).

In addition, the federal government of Canada has its own standard forms, as do the provinces (and in some cases, specific ministries), municipalities, and other public sector entities. In particular, infrastructure projects are built using standard forms developed over an extended period of time by entities such as Infrastructure Ontario.

The most commonly used form to retain an architect is the Royal Architectural Institute

Contract Form, RAIC 6. When an engineer is the prime consultant for a particular project, the contracting forms provided by the Association of Consulting Engineers of Canada are frequently used – most notably, form ACEC 2.

The International Federation of Consulting Engineers' (FIDIC) suite of contracts, which are the pre-eminent standard forms in the international construction market, as well as the New Engineering Contract (NEC) series of contracts, are not frequently used domestically in Canada.

2. Parties

2.1 The Employer

Broadly speaking, the two main categories of employers (or owners) in Canada are the public and private sectors. Public sector employers invest in infrastructure projects, such as the federal government's investment in international bridges and airports, government infrastructure, and defence projects, while provinces and municipalities invest in projects such as highways, linear transit, schools, and hospitals. The private sector invests in industrial, commercial or institutional (ICI) projects. Residential development is also a major source of private-sector employer investment across Canada

Public Infrastructure Projects

For many large public infrastructure projects, a public-private partnership (P3) model is used. While these may take many different forms, generally a government authority, as owner, contracts with a special-purpose entity formed for the project by several sophisticated domestic and/or international contractors. The special-purpose entity (commonly known as a "Project Co") then contracts with a design-builder, which in turn subcontracts with trade contractors and

suppliers, and may also be responsible for the long-term maintenance and/or operation of the finished project. Each P3 project includes a financing component, whereby the Project Co provides all or part of the financing for the design and construction.

Currently, alliancing and integrated project delivery models of contracts continue to garner increased attention in Canada. Various public entities, in particular, are implementing them on a limited basis or are exploring their use.

Laws Governing Labour and Employees

Relationships between the employer, typically the owner, and the contractor and subcontractor are governed by common law (and in Quebec, the Civil Code of Quebec). Labour laws are a provincial responsibility, although no Canadian province or territory has labour laws specific to construction projects. Laws also exist in respect of employment relationships and union labour.

Most of the provincial and territorial employment legislation establishes minimum mandatory standards and covers issues including termination, work site conditions (including health and safety), wages, and in the case of unionised environments, bargaining and other labour-related issues. Some elements of this legislation exempt construction workers from certain provisions in order to allow the construction industry to self-regulate in a way that best suits the industry. On a construction site, in addition to being an employer (of its own employees) under health and safety laws, either the contractor or the owner may be the “constructor” with specific health and safety obligations imposed under the relevant legislation. Recent case law has confirmed a “belt and braces” approach to the interpretation of health and safety obligations, by imposing concurrent, overlapping, and

broad duties on multiple workplace participants (including the owner).

2.2 The Contractor

There is a wide range of contractors in Canada, from smaller sole proprietors who work principally in the residential sector on new builds and renovations, to medium-sized regional contractors, to well-known national corporate general contractors, to large joint ventures created for individual projects. Over the past two decades, given the extent of infrastructure growth in Canada, various international contractors have entered the Canadian market in different provinces and territories.

Joint Ventures

Joint ventures are frequently formed to complete large infrastructure projects under P3 contractual arrangements. In Canada, a joint venture is defined as any two or more persons (typically corporations) who join together in a common business venture under one contract, sharing the expectation of profit and the risk of loss. Joint ventures are not defined by legislation, and therefore are not considered a separate legal entity; each party remains independent, to an extent, within the joint venture. This is most significant from a taxation perspective, as well as in regard to risk sharing, as the individual legal persons who make up a joint venture can be found jointly and severally liable for any contractual breaches or for any common law liability that the joint venture incurs.

Construction Management Arrangements

Construction Management Agreements (“CM Agreements”) are also in common use. Under a CM Agreement, the contractor is paid to manage the project and is reimbursed for its expenses, either by a fixed fee or a percentage of the construction costs. The construction manager may

share none of the project risk or may accept a degree of risk in regard to budget and schedule.

2.3 The Subcontractors

In Canada, there are a wide variety of specialised, well-established subcontractors. Contractors generally manage the relationship with their subcontractors through the use of their own standardised subcontracts, which are most commonly modified versions of industry-standard forms such as the CCDC or CCA suites (ie, those mentioned in **1.2 Standard Contracts**). Pay-when-paid provisions are a typical feature of such forms.

Bonds

A potentially important aspect of the relationship between the subcontractor and the contractor in respect of a particular project is the provision of a labour and material payment bond by the contractor. In some instances, subcontractors may also be required to obtain their own performance and labour and material payment bonds as security for the performance of the subcontractor's work and the payment of sub-subcontractors.

Holdback

As noted in **1.1 Governing Law**, in the common law provinces there is statutory lien legislation, which requires owners to retain a percentage of the contract price as "holdback". Broadly speaking, the holdback is for the benefit of the subcontractors and suppliers that supply services and materials to the improvement. In certain provinces, the same legislation establishes statutory trusts in favour of the suppliers of services and materials. In addition, some provinces have recently adopted mandatory prompt payment and adjudication into their lien legislation, with other provinces in the midst of implementing such legislation.

2.4 The Financiers

Public infrastructure projects are either funded directly by federal, provincial or municipal governments, individually or jointly, or as noted in **2.1 The Employer**, are public-private partnerships with a private sector financing component. Private sector construction projects are financed by way of self-funded investment, including share and/or subordinated debt offerings, or through various lending structures such as commercial bank loans and capital market bonds.

Loans

Loans can be secured through a variety of methods, typically in combination, such as mortgages or debentures registered against the property to be improved (provided it is owned by the developer), purchaser deposits (supported by insurance and surety products), letters of credit, bank guarantees and parent-company guarantees. Occasionally, lenders may also request assignments of planning approvals, permits, licences, or other third-party agreements. In certain circumstances, provincial lien legislation may partially subordinate mortgage security to lien rights, although such subordination is typically limited to the amount of the holdback.

Bonds

Additionally, lenders may seek indirect security through performance or labour and material payment bonds provided by the contractor. Under Ontario's Construction Act, the provision of surety bonds is a mandatory requirement in relation to public contracts (any contract between an owner and a contractor with respect to an improvement, if the owner is the Crown, a municipality or a broader public sector organisation) where the contract exceeds a specified amount. There, the contractor must provide the owner with a performance bond of at least 50% of the contract price, and a labour and material

payment bond of at least 50% of the contract price, with certain limits for larger projects.

2.5 The Designer

In Canada, architecture and engineering firms typically act as designers on construction projects and have significant responsibilities throughout the project's lifecycle. Depending on the project delivery model, the designer may be employed directly by the owner through a services agreement (under a design-bid-build contract), or may be employed by (or part of a joint venture with) the contractor (under a design build contract).

Designers may be responsible for conducting examinations of the construction site, estimating project costs, preparing final drawings and specifications, and assisting in the tendering of the project. During the course of construction, designers may also be responsible for certifying work and payments to the contractor, may perform field services, and may play a role in the resolution of disputes (as the interpreter of the contract in the first instance).

3. Works

3.1 Scope

Typically, the owner (often working with some combination of a designer, engineer and/or architect) develops the tender package to include the design and specifications for the project, including the engineering and architectural design and specifications.

In the traditional design-bid-build model, a detailed design will be prepared prior to tender. On larger projects, the design-build model may be used where the scope of work may be described in performance-based terms, as

opposed to detailed specifications, although some large projects include a 30% design (ie, one that is advanced to a reasonable degree in respect of the major design elements of the project) as part of the owner's request for proposals.

Certain aspects of the scope of the work represented in the tender documents may be negotiated by the parties if permitted by the tendering process.

3.2 Variations

The following methods are generally used by parties during the project to negotiate variations, with the specifics of the process being set out in the contract.

Change Orders

Change orders are issued by the owner or consultant, which direct the contractor to perform the variation and document an agreement between the owner and contractor as to the change to be enacted and the corresponding effect(s) on the price and/or schedule.

Change Directives

Change directives are issued by the owner or the consultant directing the contractor to complete the change contained in the documents without a prior agreement between the parties as to its effect on the price or schedule. Change directives are intended to be used where there is an urgent need to having the change implemented but there is no agreement on the cost of the change and its schedule impact. The associated price and schedule changes are then determined by the process outlined in the contract, typically either by negotiation between the parties, or by way of dispute resolution if agreement cannot be reached. Change directives can also be issued by the owner or consultant to effect a deletion of part(s) of the scope of the work. Having said this,

change directives are not typically used to enact large-scale changes, but rather smaller variations that require a quickly enacted direction to keep construction moving forward. Large-scale changes may instead be implemented via a formal amendment to the contract.

Requests for Information

Requests for information are issued by the contractor to request further information from the owner or the owner's consultant regarding an ambiguity or inconsistency within the shop drawings or other contract documents, and may be the precursor to a change order or change directive.

3.3 Design

Design-Bid-Build Model

Under the design-bid-build delivery method, the owner first enters into a contract with the designer to develop the design for the project. Once the design is complete, the project is then put out to tender and the successful bidder enters into a contract with the owner. As the designer is not a party to the construction contract between the owner and the contractor, it is the owner that bears the design risk. Of course, the designer often remains involved in the project, as the owner's consultant, to ensure that the work is performed in accordance with the contract documents and to perform various field services. However, the general contractor and the various subcontractors remain responsible for the means, methods and techniques chosen to build the project and must deliver the project in accordance with the contractual plans and specifications.

Design-Build Model

In contrast, under the design-build model, the owner contracts with a single entity to both design and construct the project, and the

design-builder will enter into a subcontract with the designer. The design-builder then bears sole legal responsibility for both design and construction.

3.4 Construction

As described in 3.3 Design, construction takes place within the context of differing delivery systems. However, unless the contract stipulates a method of construction, and subject to the schedule obligation(s) undertaken by the contractor in the contract, the contractor has complete control over the means, methods and sequence(s) of construction.

The owner's responsibilities during construction include:

- providing access to the site;
- providing the necessary supplementary information in response to reasonable requests for information;
- making payments pursuant to properly issued payment certificates; and
- considering potential changes that may be necessary to permit the successful performance of the work, such as where, for example, the design is incomplete or flawed in some respect.

Permitting is also a significant consideration, and the contract will allocate to either the owner or the contractor, or allocate between them, the responsibility for obtaining the necessary permits from government authorities.

3.5 Site

The owner is generally responsible for making access to the site available to the contractor, while the responsibility for unanticipated site conditions that may be encountered, such as pollution, underground obstacles, geotechnical

conditions, and archaeological finds, will either be allocated by the contract to the contractor, remain with the owner, or be allocated between them. This allocation varies depending on the project, with the parties attempting to allocate risk to the party best able to bear that risk. In addition, statutory liability may be imposed (eg, in respect of pollution risk) and parties are not able to contract out of that risk.

3.6 Permits

At the onset of a project, permissions in regard to land use must be secured. As detailed below, construction projects are generally required to comply with provincial building code legislation, and with municipal by-laws respecting building permits. Provincial environmental permits are required for certain classes of projects, and if fish habitats are involved, federal permits will also be required. Projects that fall within federal jurisdiction require federal licences or permits.

Examples of the Permitting Procedure *British Columbia*

For example, in British Columbia, project sponsors must obtain a development permit for construction of the precise project they are seeking to build. After obtaining a development permit, project plans and specifications prepared in accordance with all applicable codes and standards must be submitted to the municipal planning department for approval and issuance of a building permit. Once the project is complete, the project sponsors must obtain an occupancy permit following the delivery of final letters of assurance.

Ontario

In Ontario, the Planning Act, RSO 1990, provides the statutory framework for the regulation of land-use development. A preliminary project review with the municipal authority must first be

requested to determine that the proposed project complies with the municipality's zoning by-laws, following which, a zoning certificate will be issued. This step is followed by obtaining site plan approval from the municipal authority, which considers the jurisdiction's official plan and zoning by-laws. Once site plan approval is completed, a building permit application is submitted. Finally, once construction and inspections are completed, an occupancy permit will be issued if all applicable requirements under the Building Code have been met.

3.7 Maintenance

Contractual warranty provisions vary by contract, but maintenance obligations can be included in respect of a defined warranty period. Such maintenance obligations may include repair of defects or deficiencies for a stipulated period.

In addition, on some larger projects there may be a maintenance obligation in respect of the continued operation of the project for its intended use. For instance, in a P3 infrastructure project with an operation and maintenance term, the contractor will become the operator and maintainer of the infrastructure for a prescribed period while the applicable government authority retains the underlying ownership rights.

3.8 Other Functions

The obligation to rehabilitate the infrastructure asset at the end of the operation and maintenance period (ie, prior to the asset being handed back to the owner) is a common feature of P3 projects.

3.9 Tests

The general obligation of a contractor in delivering the construction project is to complete the project in accordance with the plans and specifications under the agreement (within the pro-

ject schedule). Of course, the contract will frequently call for testing and commissioning, and, generally speaking, the successful completion of testing and commissioning may form part of the precondition(s) to substantial performance. Detailed testing and commissioning plans may be required under the contract.

3.10 Completion, Takeover and Delivery

Typically, the contract will define what is required for the contractor to obtain substantial performance or substantial completion for the project as well as all the documentation, testing and commissioning, and/or other items required at the time of close-out for either owner occupancy or the turning over of the project for its intended use.

More recently, some standard form contracts (such as the CCDC 2) have introduced the concept of “Ready for Takeover” as a replacement for substantial performance, with the former terminology setting a higher standard for completion that includes requirements over and above substantial performance (eg, acquisition of occupancy permits, final cleaning and waste removal, etc).

Turnover documents will often require a close-out log from the contractor which lists the certificates for testing and commissioning, maintenance manuals, and as-built drawings, among others.

Quality assurance provisions may also apply to a project’s completion phase in order to ensure that the final product has met quality milestones throughout the project and has been deemed of good quality by the consultant or owner before turnover.

Financially, final holdback amounts will not be paid out upon substantial performance if there are deficiencies in the works that preclude the project meeting the specifications for use or occupancy. This encourages the contractor to complete the work in a way that meets the specifications.

3.11 Defects and Defects Liability Period Construction Warranties

Warranty periods are typically specified in a construction contract. A construction warranty provides a remedy to the owner for non-conformance with the contract.

Under the CCDC standard forms, there is a construction warranty period for one year from the date of substantial performance of the work. The contractor is responsible for correcting, at its own expense, defects or deficiencies in the work which appear during the specified-year warranty period. Extended warranties may be defined in the contract documents for certain portions of the work. Also, some contracts require the basic warranty period to run for an extended period, such as two years or more.

Latent Defect Regime

Contracts may also include a latent defect regime for a longer period of time, where contractors will be held responsible for latent defects which were not discoverable at the time of contract completion.

4. Price

4.1 Contract Price

The basic methods of establishing the contract price in Canada are unit price, fixed price, and cost plus.

Methods to Calculate the Contract Price

Unit price

Unit price contracts attribute specific prices to each individual work unit, which results in a total contract price that is variable, depending upon the number of units supplied – although there may also be a guaranteed maximum price. In order to calculate the total contract price, the parties simply multiply the units supplied by their respective price and add the totals of the individual items together.

As the quantities, nature and cost of each work unit are critical components of the unit price contract, one benefit of the unit price method is that it allows parties to renegotiate the cost of each work unit.

Fixed price

A fixed price (or lump sum) contract is a contract in which the parties agree to a pre-determined price for the defined scope of work.

Cost-plus

A cost-plus contract, on the other hand, is a contract that utilises an agreement to pay the contractor's costs, plus a fee.

Milestone Payments

Milestone payments are often used on larger contracts. There may be a number of significant milestones which result in payments and are intended to incentivise prompt performance of the work.

4.2 Indexation

Material price escalation clauses can be employed in construction contracts in order to address potential cost fluctuations over the project's duration, particularly in long-term projects. Although indexation of prices is not com-

monly used in construction contracts, its use has increased since the COVID-19 pandemic.

4.3 Payment

Contractual Payment Mechanisms

Most commonly, payment is pursuant to monthly certification of progress draws (requests for payment), based on a percentage of completion of the works. The percentage that has been completed is measured in relation to a schedule of quantities agreed to at the commencement of the contract and is typically certified by the "payment certifier" (the owner's architect or engineer) or an "independent certifier". Payments may also be certified on a milestone basis. Standard form contracts such as CCDC contracts, for example, provide for interest to apply in the event that a party fails to make payments as they become due. Many bespoke contracts provide for the same.

Statutory Payment Mechanisms

In addition to these contractual payment mechanisms, however, Canadian construction contracts may also be subject to a statutory payment mechanism, depending on the jurisdiction in which the project is situated. For example, the Province of Ontario has legislated a mandatory prompt payment mechanism within the Construction Act, which is intended to ensure that all parties on the construction pyramid are paid in a timely manner. At a high level, the prompt payment regime requires contractors to provide a "proper invoice" to the owner, which triggers the start of a period leading up to the payment deadline, subject to a right to dispute part or all of the amounts claimed in an invoice. The prompt payment mechanism also provides for mandatory interest on late payments.

A number of Canadian provinces have adopted or are in the process of adopting similar payment

legislation to facilitate timely payments in the construction industry. For example, The Builders' Lien (Prompt Payment) Amendment Act, 2019 and related regulations came into force on 1 March 2022 in the province of Saskatchewan and include a prompt payment and adjudication regime, while Alberta's Prompt Payment and Construction Lien Act came into force on 29 August 2022.

Importantly, the federal government has also introduced a prompt payment regime which applies to federal construction projects. Standard form contracts are in the process of adapting to these new prompt payment regimes.

Advance and Interim Payments

Advance payments are used on some construction projects – though security may be required in respect of such payments. Interim payments are common in the form of interim milestone payments (see 4.1 **Contract Price**).

4.4 Invoicing

As noted in 4.3 **Payment**, the primary method and timing of payment for construction work is by way of regular progress claims during the course of the project. Generally, the construction contract provides that these amounts are due and owing 30 to 45 days after submission. The payment mechanism is typically triggered when the registered professional or consultant for the project certifies payment, if there is a payment certifier under the contract, and if there is not, when the owner certifies the payment.

In Ontario, the prompt payment mechanism described in 4.3 **Payment** requires that invoices be provided to the owner on a monthly basis, unless otherwise provided in the contract (which permits the use of milestone payments). Under the legislation, the owner must then pay the con-

tractor within 28 calendar days of receiving the invoice, subject to the owner's right of delivering a notice of non-payment.

5. Time

5.1 Planning and Programme

The contractor is generally responsible for the schedule pursuant to the construction contract. Contractors are typically required to prepare a construction schedule and provide it to the owner during the request for proposal (RFP) or call for tenders period, or within a defined period after contract execution. The proposed schedule is sometimes negotiated prior to contract formation, and then becomes the contractual schedule. Subsequently, the contractor will usually be required to provide monthly schedule updates. In the event that the project falls behind schedule, the contract may require the contractor to provide a recovery plan.

5.2 Delays

In the event of delay, the contractual outcome(s) depend(s) upon the nature of the delay and, in particular, whether the delay is caused by the contractor or the owner, or neither of them (ie, unanticipated circumstances).

Delays Caused by the Contractor

For example, if the contractor is responsible for a delay as a result of failing to obtain appropriate municipal approvals or co-ordinate subcontractors or materials, the owner is generally able to claim against the contractor for losses suffered as a result of the delay, including by levying liquidated damages (LDs), if the contract provides for schedule-related LDs. Owners may be entitled to set off such amounts from the contract price.

Delays Caused by the Owner or Its Consultant

On the other hand, an owner or its consultant may also be responsible for causing delay if, for example, there are delays in allowing access to the site, delays in the owner obtaining permits, increases or changes in the scope of the work, design errors, or if Requests for Information (RFIs) are not answered in a timely manner. Sometimes, construction contracts limit the contractor's ability to claim against the owner for its direct costs associated with the delay and place the contractor under strict notice obligations in this regard.

Delays Due to Unexpected Circumstances

Finally, if the contractor is delayed due to unexpected circumstances, such as a flood, severe weather conditions, earthquake, or any other natural occurrences commonly referred to as "acts of God", construction contracts will typically include force majeure provisions (discussed in **5.5 Force Majeure**) that will allow the contractor to obtain schedule relief and be excused from performing its contractual obligations for the duration of the force majeure event.

Delays may also result from unforeseen site conditions such as contamination and geotechnical conditions. Such claims will be addressed based on the contractual risk allocation – which can vary between contracts.

Owner-supplied equipment or material can also give rise to claims if there are delays in delivery or if the equipment or material is not fit for the purpose intended.

5.3 Remedies in the Event of Delays

As explained in **5.2 Delays**, an owner may in theory set off or deduct damages from the con-

tract price for the damages it suffers as a result of delays caused by the contractor.

In Canada, construction contracts generally include notice provisions which provide formal requirements in relation to the timing and manner in which one party may make and deliver a claim for delay against the other.

These provisions often provide that if the delay claim is not advanced within the prescribed time and manner (ie, notice typically must be in writing), the entirety of the claim will be barred. Canadian courts have generally upheld these notice provisions as valid and binding unless the conduct of the parties demonstrates that they are not abiding by the notice provisions. In such cases, a party may be estopped from relying on the notice provision to bar a delay claim, or may be found to have waived such right.

However, Canadian courts have not been uniform in their treatment of notice provisions – whereas some courts (such as the Ontario courts) have interpreted such provisions according to a theory of strict compliance, others (such as the British Columbia courts) have occasionally adopted a somewhat more relaxed approach in allowing for constructive notice to satisfy contractual notice requirement(s). Under either approach, the specific wording of the notice provision in question will largely dictate a court's analysis of whether timely and sufficient notice was provided.

5.4 Extension of Time

Although there are various methods by which a contractor may request an extension of time, a common method is by way of change order request. As noted in **3.2 Variations**, a change order is a written document that details a change in the work and the agreed terms of that change. In addition to detailing an increase to the con-

tract price, change orders may also provide contractors with an extension of time.

In larger, more complex construction contracts for P3 projects, there are robust mechanisms through which a contractor or Project Co may claim additional contract time as a result of supervening events, including by claiming a delay event, for example. With respect to extensions of time, contracts often require the claiming party to prepare a critical path analysis which demonstrates the impact on the completion date of the project. Further, construction contracts will often include provisions which establish how concurrent delays are to be treated in relation to a contractor's request for schedule relief.

5.5 Force Majeure

Force majeure provisions within construction contracts operate to excuse a party's performance to the extent that its failure to perform is caused by a particular extreme circumstance outside the party's control, but which has not satisfied the common law doctrine of frustration. The construction contract will define what constitutes force majeure.

A party which intends to rely on a force majeure provision to relieve it from liability must provide sufficient evidence to establish that the force majeure event is the actual cause of the party's inability to perform its contractual obligations.

Parties to a construction contract may negotiate the specific circumstances which would constitute a force majeure event.

Ultimately, each force majeure provision should be considered and interpreted separately and in the light of the contract as a whole.

5.6 Unforeseen Circumstances

Although special considerations apply in the Province of Quebec, the treatment of unforeseen site conditions is generally governed by the construction contract.

Claims in respect of unforeseen site conditions are often brought by the contractor and may relate to soil and water-related issues, including, for example, environmental contamination. In brownfield projects, unforeseen conditions can include issues encountered behind walls and ceilings, and beneath floors. Generally, these disputes involve claims by the contractor that the site conditions were not adequately disclosed to the contractor prior to the execution of the contract. Such claims may also include more serious assertions involving misrepresentations in relation to the site conditions.

Importantly, construction contracts commonly require a contractor to investigate the site. If a contractor is provided an opportunity to investigate the site but fails to conduct its due diligence in accordance with good industry practice, the contractor may be barred from advancing a claim based on unforeseen site conditions.

If successful, an unforeseen site conditions claim by a contractor may lead to significant additional costs being borne by the owner, as well as significant schedule extension(s). Therefore, the language of the construction contract is vitally important to ensure that the parties fully appreciate the allocation of risk. In that regard, it is not uncommon for owners to warrant the accuracy of geotechnical information provided to bidders, but not the completeness.

5.7 Disruption

Disruption claims are not infrequently advanced on construction projects in Canada, although it is

not a freestanding ground for legal relief. Rather, parties must identify a legal basis for relief under the contract (eg, a breach of contract, including prevention), and then rely upon disruption as a means of quantifying their entitlement to compensation and/or an extension of time.

In that regard, parties advancing disruption claims will invariably rely on expert evidence from delay and/or quantum experts, which evidence is typically the subject of significant disagreement in disputes, even where legal entitlement is undisputed. In that regard, disruption can be measured according to a number of different methods commonly used across the world, including the measured mile approach, earned value analysis, and total cost (or modified total cost). In each instance, disruption analysis considers contemporaneous project records to the extent they are available, as a result of which parties are well advised to keep detailed project records.

6. Liability

6.1 Exclusion of Liability

Limitations of liability can be included in Canadian construction contracts. However, where provinces or territories have legislation which provides for liens and/or statutory trusts, the applicable legislation voids any attempts to exclude the legislative scheme. Again, Quebec represents a special case in this regard. Outside of such considerations, in Canada, parties are free to contract among themselves as they see fit regarding exclusion clauses, subject to certain common law duties of good faith (discussed in **1.1 Governing Law**), out of which parties cannot contract.

6.2 Wilful Misconduct and Gross Negligence

Broadly speaking, the contractual consequences of wilful misconduct are not regulated by statute or regulation. Rather, damages stemming from the wilful misconduct or gross negligence of a party are frequently excluded from limitation of liability provisions. Having said this, from both common law and civil law perspectives, it is unlikely that a party could successfully rely on a limitation of liability provision to protect itself from the consequences of an intentional breach, while gross negligence introduces the issue of recklessness.

6.3 Limitation of Liability

Parties can agree to contractually limit their liability. Exclusion of liability clauses are common in construction insurance and construction contracts in Canada and are generally enforceable as long as the circumstances, viewed objectively, are consistent with the parties' mutual intentions at the time of contracting, are not unconscionable, and do not go against public policy. In this regard, the bar for refusing to enforce a contract or clause on the basis of public policy is very high, and rarely invoked by the courts. This applies to all construction parties as per the Supreme Court of Canada in *Tercon Contractors Ltd v British Columbia (Transportation and Highways)*, (2010) 1 SCR 69, 2010 SCC 4.

The parties frequently place a cap on liability in professional services agreements between owners (and contractors) and consultants. Such caps are commonly related to the fee for the service provided by the consultant or the amount of professional liability insurance required by the contract, so that the consultant's liability is limited to the amount of coverage they have under their professional liability insurance.

7. Risk, Insurance and Securities

7.1 Indemnities

Indemnities are intended to hold one party liable for any loss or damage incurred by the other party in connection with the services performed. Generally, the parties to a construction contract are free to indemnify one another from claims by third parties, typically in regard to personal injury, property damage, and defects in title, as well as from the consequences of breaches of contract (subject to any applicable limitation of liability provision and taking into account insurance considerations).

7.2 Guarantees

Bonds protect against financial loss due to a party failing to meet project specifications. Bonds serve as a guarantee that should the contractor fail to complete the project (a performance bond) or fail to pay its subcontractors (a labour and material bond), the owner's project will be completed and the subcontractors will be paid.

Another relevant type of surety bond is the bid bond, which provides a way to obtain financial security during the contract bidding process. Bid bonds secure the interests of the owner by establishing a promise from the surety to the owner that if the successful bidder fails to enter into a contract with the owner, the surety will compensate the owner, typically to the extent of the difference in price between the defaulting lowest bidder and the second lowest bidder.

Under a parent company guarantee, the parent company will assume the completion of the project if its subsidiary is unable to bring the project to completion. It is important to highlight that this method of guarantee may provide minimal benefit, especially where the insolvency of a

contractor includes the insolvency of the parent company.

7.3 Insurance

Insurance is critical to the successful risk management of a construction project. Generally, the most important insurance policies found in construction projects are builder's risk policies, commercial general liability/wrap-up liability policies, and professional liability policies.

Various other insurance policies are used in construction projects, such as contractor's equipment insurance, boiler and machinery insurance, and pollution insurance. Furthermore, any party employing workers in Canada must participate in workers' compensation plans, governed by the provincial governments.

7.4 Insolvency

Canadian construction contracts typically provide that the insolvency of the contractor is grounds for termination. However, if the contractor takes the protection of federal insolvency legislation, the owner may be subjected to a stay of proceedings that prevents termination. Conversely, the Supreme Court of Canada's decision in *Peace River Hydro Partners v Petrowest Corp*, 2022 SCC 41 clarified that in circumstances of an insolvency, a receiver may itself be prevented from pursuing litigation against the insolvent contractor's debtors if the contractor and debtor had previously agreed to arbitrate any disputes. Whether a receiver can pursue litigation or must stay the litigation in favour of arbitration will depend on the particular facts of a given case.

Products That Protect against Insolvency

The various products that are intended to protect an owner against the risk of insolvency include surety bonds, default insurance, letters of credit, and parent company guarantees. Performance

bonds also serve as an important guarantee that should the contractor fail to complete the project, or fail to pay its subcontractors, the owner will be compensated and the subcontractors will be paid. Default insurance is designed to protect a general contractor from the financial loss of default by its subcontractors and suppliers by transferring the risk of subcontractor default from the general contractor to the insurer. Letters of credit are often used in construction projects to secure the performance of a contractor's obligations to the owner.

As mentioned in 7.2 **Guarantees**, a parent company guarantee is another form of performance security in which a parent or holding company guarantees the performance of its subsidiary. However, this method of guarantee provides minimal benefit where the insolvency of a contractor arises out of the insolvency of the parent company.

Supreme Court Decision

By contrast, the Supreme Court of Canada has clarified in *Chandos Construction Ltd v Deloitte Restructuring Inc.*, 2020 SCC 25 that it is not open to the parties to a construction contract to agree that upon insolvency, the contractor will forfeit any portion of the contract price to the owner. Such an arrangement violates bankruptcy and insolvency common law and legislation.

7.5 Risk Sharing

Traditionally, apart from bonus/penalty provisions and certain guarantee price contract mechanisms, risk sharing in construction contracts has been uncommon. Risks are generally divided between the owner and the contractor during the contract negotiation phase. However, relatively recently, a new form of risk sharing called alliance contracting has been introduced in Canada. Alliance contracting is a contract

structure between an owner and a number of project participants including lenders, contractors and designers, to collectively undertake a construction project in which all parties work to achieve the same project-wide goals.

Alliance contracting allows for risk sharing, so that each party individually holds less risk for the project, often with additional contractual terms intended to lessen the likelihood of disputes. Alliance contracting is similar to integrated project delivery or progressive design-build; however, alliance contracts provide for a greater amount of risk sharing between the parties.

8. Contract Administration and Claims

8.1 Personnel

In large projects, personnel who are critical to the performance of the project are often included in bids and identified as key individuals. Once the contract is executed, there are often provisions which require key individuals to be named and approved by the owner or consultant, as well as provisions which explain the process for removing and/or replacing key individuals. In most construction contracts for smaller projects, specific personnel are not named, nor is there a process to include or vary key individuals, although it is relatively common even on smaller projects for bidders to include CVs of relevant personnel as part of their bid.

8.2 Subcontracting

Construction contracts with subcontractors can be as formal and detailed as those between owner and contractor or can be in a more simplified form. For larger projects, standardised subcontracts such as those published by the CCA may be used, or as noted in 2.3 **The Sub-**

contractors, major contractors have bespoke subcontract forms.

Subcontracts can incorporate the obligations of the contract between the owner and contractor if the language is clear and the subcontractor is given a copy of the prime contract. Without such clarity or provision of the prime contract, these obligations are unlikely to be fully passed down to the subcontractor in the event of a dispute.

In provinces with lien legislation, there are mandatory provisions which require the contractor to retain specified holdback amounts for the benefit of the sub-subcontractor or supplier.

8.3 Intellectual Property

Concerns regarding intellectual property in Canadian construction contracts involve the design drawings and documents, which are most often an issue in respect of larger projects. Intellectual property provisions in such contracts will set out detailed requirements regarding the use of intellectual property, including which party retains rights to the intellectual property in question.

9. Remedies and Damages

9.1 Remedies

For Contractors and Subcontractors

As noted in **1.1 Governing Law**, the common law provinces and territories have lien legislation in place which protects the contractor and subcontractor in respect of unpaid amounts, at least to the extent of the statutory holdback. In addition, in the majority of the common law provinces, statutory trust rights exist that permit the contractor and/or the subcontractors to pursue the owner (or contractor) to recover funds that

were earmarked for the project but have been diverted.

Of course, the most common remedy is compensation for breach of contract.

For Owners/Employers

From the owner's perspective, a common remedy in the event of certain types of breaches of contract is liquidated damages. These operate as per the contractual terms, and can accrue daily, include interest, and be used as a deterrent (such as attaching to a failure to provide timely documentation). The owner is often able to set off, or deduct, from the progress draws for such damages, minus any statutory holdback.

However, liquidated damages clauses must represent a genuine pre-estimate of the owner's damages in the case of the contractor's default, or else the clause may be found to be a penalty clause and therefore unenforceable.

Again, the most common remedy is compensation for breach of contract.

9.2 Restricting Remedies

Remedies may be limited contractually in so far as freedom of contract permits. Remedy provisions that are unconscionable or which could be found to go against public policy may be voided by the court should a dispute arise. Common law rights of termination may also be limited by express default/termination and dispute resolution provisions. As noted in **1.1 Governing Law**, the remedies provided by lien legislation cannot be limited by the contract.

9.3 Sole Remedy Clauses

These clauses provide that to the extent rights and remedies are provided in the contract, such rights and remedies are the exclusive rem-

edy available for the event described. Generally speaking, they are enforceable through the courts.

9.4 Excluded Damages

Limitation of liability clauses are commonly included in construction contracts and typically exclude consequential damages from liability, with consequential damages including loss of profit, loss of use, and other “indirect” damages.

The enforceability of such clauses is determined through a plain and literal reading of the language in the provision. In *Tercon Contractors Ltd v British Columbia (Transportation and Highways)*, 2010 SCC 4, the Supreme Court of Canada released a three-part test outlining the applicability of exclusion of liability clauses which included:

- looking to the language of the clause and whether the clause applies to the specific circumstances at hand;
- assessing whether the clause is unconscionable; and
- considering whether there is an overriding public policy reason to justify not applying the provision.

As noted above, courts very rarely invoke public policy as a justification for finding a contract or clause unenforceable. Similarly, it is unlikely in the construction context for a party to succeed in arguing that a clause is unconscionable, particularly where the contract involves two sophisticated parties.

9.5 Retention and Suspension Rights

Some contracts provide for the owner’s right to suspend the project (which is, of course, to be distinguished from an owner’s contractual right of termination for convenience). Certain suspen-

sion rights are also provided for by way of legislation. For example, Ontario’s Construction Act, RSO 1990, c. C. 30 provides contractors and subcontractors with suspension rights in relation to non-payment.

Under the Construction Act, RSO 1990, c. C. 30, if an amount payable to a contractor or subcontractor under an adjudication determination is not paid by the party when it is due, the contractor or subcontractor has the right to suspend further work under the contract or subcontract. The contractor or subcontractor may suspend work until the party pays the following:

- the amount required to be paid under the determination;
- any interest accrued on that amount; and
- any reasonable costs incurred by the contractor or subcontractor as a result of the suspension of work.

Furthermore, a contractor or subcontractor who suspends work for the reasons above is entitled to be paid for any reasonable costs incurred by them due to the resumption of work following the payment.

9.6 Termination

Broadly speaking, construction contracts typically provide for termination for default, which allows either the owner or contractor to terminate the contract if the other party engages in any act(s) which the contract identifies as an event of default. Examples of events of default found in standard form contracts include, without limitation, insolvency or bankruptcy, a failure to prosecute the work, abandonment of the work, and persistent failure to pay amounts due and owing. If the contract does not specifically identify events of default, breach of certain terms

may still amount to a default if the term is identified as a condition rather than a warranty.

In the event of a termination of the contractor for default, the contractor will typically be entitled to its costs of the work it has performed up to the date of the termination, and potentially profit thereon, although typically the contract will stipulate that the owner's additional costs of completion are to be set-off against such an entitlement.

By contrast, some construction contracts may include a termination for convenience provision, which typically provides the owner (but the not contractor) with the ability to terminate the contract for any reason, at its discretion. That being said, case law from the Supreme Court of Canada (see *Greater Vancouver Sewerage and Drainage District v Wastech Services Ltd*, 2021 SCC 7) has confirmed that a contractual discretion must be exercised reasonably, meaning it must be exercised consistent with the purpose(s) for which it was conferred.

Similar to a termination for default, a termination for convenience will typically entitle the contractor to its costs performed up to the date of the termination, as well as profit thereon, but will not entitle the contractor to anticipated profits for work not performed. In any event, however, compensation will depend on the exact terms of the termination for convenience provision. There is scant case law on termination for convenience in Canada, as a result of which there are a number of unsettled points, such as whether the contractor would be entitled to its demobilisation costs, and whether a bad faith termination for convenience entitles the contractor to all of its anticipated profits.

10. Dispute Resolution

10.1 Regular Dispute Resolution

In Canada there are no specialist courts to hear construction disputes, though in Ontario there are some associate justices (formerly known as masters) who specialise in construction lien matters (though currently only in the city of Toronto). In practice, however, most construction disputes proceed to mediation or arbitration, which is addressed in **10.2 Alternative Dispute Resolution**.

In addition to the courts, some provinces have introduced mandatory statutory adjudication regimes aimed at facilitating efficient dispute resolution that is interim binding. In Ontario for example, adjudication under the Construction Act provides for the swift resolution of disputes pertaining to the valuation of services or materials provided under the contract, payment under the contract and the non-payment of holdback, among other things. In Ontario, adjudication continues to gain popularity.

10.2 Alternative Dispute Resolution

As courts tend not to be equipped with the technical expertise to hear complex disputes in the construction and infrastructure industries, mediation and arbitration have largely occupied this field.

Mediation

Mediation has been widely used to resolve construction disputes since the early 1990s. Mediation has been highly successful and continues to have broad application today. In fact, mediation is often mandated in complex construction contracts as part of the contractual dispute resolution process.

Arbitration

Arbitration is also frequently used to resolve construction disputes in Canada. In fact, in Canada it is not uncommon for government agencies to participate in private arbitration. It is worth noting that all arbitration proceedings, including those involving government agencies, are subject to provincial arbitration legislation. That being said, there is federal arbitration legislation which applies in respect of contracts in which federal Crown corporations or agencies are involved.

Dispute Resolution Boards

Though not nearly as widely used as mediation or arbitration, contracting parties are also increasingly using dispute resolution boards to efficiently resolve disputes on an advisory, mandatory, and interim basis. A dispute resolution board is a panel which is appointed at the outset of the project, and which is generally comprised of independent technical experts or highly experienced individuals who regularly attend the site and address disputes as they arise.

Dispute Resolution Schemes

In addition, certain construction projects also rely upon bespoke dispute resolution schemes that provide for different forums to resolve different types of disputes. For example, these schemes could include any or all of mediation, arbitration, and dispute adjudication boards, as well as referral of technical issues to the contract's independent certifier. In addition, these dispute resolution schemes typically require the parties to engage in various attempts at party-level discussions amongst differing levels of management in an effort to resolve disputes, typically on a without prejudice basis.

Trends and Developments

Contributed by:

Trish Morrison KC, Simon Grégoire, James MacLellan and Michael Skene
Borden Ladner Gervais LLP

Borden Ladner Gervais LLP (BLG), as one of Canada's largest and most specialised construction law teams, has a comprehensive understanding of the construction industry, both domestic and international. Its experience, and national breadth and depth, allow it to anticipate and identify risks early, and to provide clients cost-effective and innovative solutions on construction and infrastructure projects across the country. The team works with clients throughout the entire lifecycle of a construction project. Front-end construction lawyers advise on project delivery models, construction-relat-

ed agreements and provide advisory services during the project. BLG's team of construction litigators is one of the most highly regarded in Canada for handling complex, multi-party and multi-jurisdictional disputes which it resolves through litigation, arbitration and mediation. Clients include project owners, engineers, architects, insurers, general and specialised contractors, manufacturers, suppliers, developers, property managers, surety companies and financial institutions. BLG has ten lawyers in the prestigious Canadian College of Construction Lawyers.

Authors



Trish Morrison KC is a partner and the national business leader of BLG's construction group. She provides strategic advice to owners, contractors, architects and engineers for the

management of risk on construction projects, from project start to completion. Trish has extensive experience in the mediation, arbitration and litigation of complex construction disputes on large-scale commercial, industrial, and infrastructure projects. She also advises on front-end project matters such as project delivery models, procurement, contracts and project advisory services. Trish is the President of the Canadian College of Construction Lawyers. Trish is recognised as a Leading Lawyer in Construction in Chambers Canada.



Simon Grégoire is a partner and member of BLG's construction group and international trade and arbitration group. He has been involved as lawyer or arbitrator in several large-scale

disputes, nationally and internationally, concerning major infrastructural projects. Simon is a Fellow of the Chartered Institute of Arbitrators and the Canadian College of Construction Lawyers. He serves regularly as a trainer in workshops for younger lawyers on the art and techniques of trial advocacy. He graduated from McGill with a BCL and LLB and from the University of London with an LLM in international business transactions. Simon was called to the Québec Bar in 1988.

CANADA TRENDS AND DEVELOPMENTS

Contributed by: Trish Morrison KC, Simon Grégoire, James MacLellan and Michael Skene,
Borden Ladner Gervais LLP



James MacLellan is a partner in the BLG construction group. He is recognised as one of the leading surety bonding practitioners in Canada. The majority of his practice is spent

on advising sureties on complex insolvency, litigation, workouts, and risk mitigation matters. He acts as lead surety counsel in the largest construction defaults across Canada. James has appeared on surety law matters in the Supreme Court of Canada and Courts of Appeal in Ontario, Manitoba, and Alberta, and in the Supreme Courts of Nova Scotia, Saskatchewan, and Newfoundland and Labrador.



Michael Skene is a partner at the Vancouver office of BLG. His degrees are from the University of Cambridge (LLM), University of Toronto (JD) and UBC.

Michael advises clients on a range of construction and infrastructure matters, with extensive experience in dispute-related issues. His clients include contractors, developers and sureties. Michael has successfully represented clients before various tribunals, provincial and superior courts, and in the Supreme Court of Canada. He has worked with clients to resolve some of the largest construction claims in Canada in the past two decades, including individual disputes in excess of CAD1 billion.

Borden Ladner Gervais LLP

Bay Adelaide Centre, East Tower
22 Adelaide Street West
Suite 3400
Toronto, Ontario Canada
M5H 4E3

Tel: +1 416 367 6000
Fax: +1 416 367 6749
Email: info@blg.com
Web: www.blg.com

BLG
Borden Ladner Gervais

Contributed by: Trish Morrison KC, Simon Grégoire, James MacLellan and Michael Skene,
Borden Ladner Gervais LLP

The State of the Construction Industry in Canada

The construction industry is robust in Canada, despite a number of challenges currently facing the industry. Significant labour shortages and supply chain issues continue to impact construction and are causing uncertainty in availability and costing within the industry. Financial pressures continue to impact contractors and cause contractor insolvencies, resulting in a trend of increased bond claims. Arbitration and other alternate dispute resolution processes continue to be a preferred method for resolving construction disputes, where possible. There is a continued recognition of the benefits of early contractor involvement and co-operative contracts, resulting in a move towards collaborative project delivery models. Modular construction, as well as the use of drones and digital technology on projects, are becoming more common place. In addition, other trends have emerged in the construction industry, legislation and the courts which are discussed in more detail below, including:

- ongoing implementation of prompt payment legislation across Canada;
- expanded responsibility for work site occupational health and safety;
- recent treatment of the lowest compliant bidder rule in tendering; and
- developments in surety law.

Update on Prompt Payment Across Canada

The shift towards prompt payment and adjudication in the construction industry continues to expand across Canada. As of April 2024, three provinces have implemented prompt payment legislation, four more have passed legislation which is not yet in force and, most recently, the federal legislation is now in effect.

Ontario was the first province to pass prompt payment legislation when it amended the Construction Act, R.S.O. 1990 c. C.30. The Ontario prompt payment provisions came into force on 1 October 2019. In Ontario, an owner has 28 days to pay a monthly invoice submitted to a contractor. The contractor, upon receiving the full payment, has seven days to pay its subcontractors for amounts owed in those invoices. Parties to a contract may refer a dispute to interim adjudication for the following issues:

- service and material valuation;
- payment under a contract, notices of non-payment;
- amounts retained through set-off, payment of holdbacks; or
- any other matters agreed by the parties.

The amended provisions set out the requirements and timelines for adjudication, which is mandatory under the legislation. Ontario has designated the Ontario Dispute Adjudication for Construction Contracts to be the authority to handle adjudications. Almost five years after the implementation of the amended legislation, the Ontario Attorney General recently announced that the province will be conducting a two-phased review process of the Ontario Construction Act to identify and prioritise possible improvements to the legislation. This process is planned to be complete by the fall of 2024.

Nova Scotia amended and renamed its Builders' Lien Act, R.S.N.S. 1989, c. 277 (renamed the Builders' Lien and Prompt Payment Act) on 12 April 2019. The legislative provisions are general, mirroring the Ontario provisions. However, the details, such as timelines for payments and procedures for adjudication, will be established by regulation. The Nova Scotia Act is not yet in force. However, in 2023, the province consulted

Contributed by: Trish Morrison KC, Simon Grégoire, James MacLellan and Michael Skene,
Borden Ladner Gervais LLP

with industry to develop the regulations under the Nova Scotia Act, which suggests that the amended Act may come into force soon.

Saskatchewan amended The Builders' Lien Act, S.S. 1984-1985-86, c. B-7.1, with The Builders' Lien (Prompt Payment) Amendment Act, S.S. 2019, c. 2 on 25 May 2019. Saskatchewan's amendments are similar to Ontario's prompt payment provisions, with similar timelines of 28 days for owners to pay contractors and seven days for contractors to pay subcontractors. The adjudication process in Saskatchewan allows more issues to be adjudicated than the Ontario regime, such as failing or refusing to certify substantial performance. The amendments came into force on 1 March 2022, but the new provisions only apply to contracts entered into on or after 1 March 2022 and only to subcontracts with main contracts entered into on or after 1 March 2022.

In Alberta, the government passed the Prompt Payment and Construction Lien Act, RSA 2000, c P-26.4, which came into force on 29 August 2022. As of 29 August 2022, all new construction contracts in Alberta are required to adhere to the new Act and existing contracts must be compliant with the new Act within two years of the Act coming into force. The Alberta Act includes prompt payment requirements that are similar to Ontario.

Similarly, the federal government of Canada has passed the Federal Prompt Payment for Construction Work Act, S.C. 2019, c. 29, s. 387, which provides for a prompt payment regime for federal public construction projects. This Act received royal assent on 21 June 2019 and came into force on 9 December 2023. The prompt payment provisions will apply to all federal contracts after 9 December 2024. The prompt payment

provisions are similar to the Ontario regime. The adjudicatory authority for the Federal regime is the Canada Dispute Adjudication for Construction Contracts. The Act permits the federal government to exempt provinces from the federal regime if they have adopted equivalent legislation. On 8 December 2023, the federal government exempted Ontario, Alberta and Saskatchewan on this basis.

In Quebec, the Chair of the *Conseil du Trésor* implemented a pilot prompt payment and adjudication regime in 2018, which tested monthly invoicing, payment timelines set to certain days in the month, and an adjudication process for disputes "likely to affect payment" on 52 public construction contracts. Quebec has given a permanent effect to prompt payment legislation by passing An Act mainly to promote Québec-sourced and responsible procurement by public bodies, to reinforce the integrity regime of enterprises and to increase the powers of the *Autorité des marchés publics* (SQ 2022, c 18). The Act received royal assent on 2 June 2022. The Act is not yet in force.

Similarly, in Manitoba, the government passed The Prompt Payment for Construction Act on 30 May 2023, which amends the Manitoba's Builders' Liens Act. The amendments received royal assent but are not yet in force. The regulations have not yet been published. Like other provinces, Manitoba's Act will require owners to pay contractors no later than 28 days after a proper invoice is given to the owner by the contractor. The new Act will apply to contracts or subcontracts entered into on or after the date the amendments come into force.

In New Brunswick, on 9 May 2023, the legislature issued the Construction Prompt Payment and Adjudication Act. The Act received royal assent

Contributed by: Trish Morrison KC, Simon Grégoire, James MacLellan and Michael Skene,
Borden Ladner Gervais LLP

on 16 June 2023, and introduced a prompt payment and mandatory adjudication regime in the province. This Act is not yet in force. It is generally modelled after Ontario's prompt payment and adjudication regime.

In British Columbia, the legislature has not passed prompt payment legislation but has previously introduced a private member's bill (Bill M-233) on 28 May 2019, which did not progress past the first reading. The province has not yet tabled any legislation. In late 2023, the Ministry of the Attorney General's staff commenced a large table working group with interested associations and groups to consult on the creation of prompt payment legislation in British Columbia.

Prince Edward Island, Newfoundland and Labrador and the Territories do not currently appear to have a plan to develop prompt payment legislation.

The policy of governments across much of Canada is clear – timely payment of contractors and subcontractors in the construction industry is a priority. Prompt payment is no longer just an emerging trend but could soon be an established norm for the majority of the country.

Responsibility for Work Site Occupational Health and Safety

On 10 November 2023, the Supreme Court of Canada (SCC) released its decision in *R. v Greater Sudbury (City)* (Sudbury), a case which addresses whether the owner of a construction project should be considered an “employer” under the Occupational Health and Safety Act (the “Act”). Due to a split decision by the SCC, the prior decision of the Ontario Court of Appeal will remain in place, which held that the project owner was an “employer” and shares liability under the Act for health and safety on the

project. Unsurprisingly, this decision has been polarising across the construction industry in Canada, with many criticising the decision for being divorced from reality, while others applauded the decision for championing the “belts and braces” approach to workplace safety.

The City of Greater Sudbury (the “City”) contracted with Interpaving Limited to act as “constructor” to repair a water main (the “Project”). Under the Act, the “constructor” is the party who is to ensure that the health and safety of all workers on the project is protected. The City also employed inspectors to attend the Project site for quality assurance purposes. During the Project, a pedestrian was tragically struck and killed while crossing an intersection. The Ministry of Labour investigated the incident and determined that the Project lacked safety measures, such as a fence and signaller, contrary to the safety regulations. The Ministry charged the City, among others, with breaching its purported obligations as “constructor” and “employer” under the Act.

At the lower court levels, the City was successful in arguing that it was not the “constructor” or “employer”. However, the Ministry appealed, and the Ontario Court of Appeal found that the City was an “employer”. Upon further appeal, the SCC arrived at a split decision (4-4), resulting in the Court of Appeal decision remaining in place. As such, Sudbury does not provide the clarity project owners were seeking about their health and safety obligations.

The SCC judges who supported the Court of Appeal decision found that nothing in the Act required the Ministry to establish that the City had control over the workers or workplace to prove the City breached its obligations as “employer” under the Act. They found that the City met the definition of “employer” under the Act, having

Contributed by: Trish Morrison KC, Simon Grégoire, James MacLellan and Michael Skene,
Borden Ladner Gervais LLP

both employed quality control inspectors and by hiring Interpaving as “constructor”. The other SCC judges held that it would be absurd to interpret the Act in a manner that could arguably obligate every “employer” at a construction project to ensure compliance with all measures contained in the safety regulations.

Notwithstanding the split decision, the majority of the judges noted that the City could avoid conviction of the strict liability offence if it could show it exercised due diligence under the Act. However, the issue of due diligence was not decided by the SCC, and the case was sent back to the provincial offences appeal court for determination. For now, the viability of the due diligence defence in circumstances where an owner retains a “constructor” remains uncertain.

After the decision was released, the City filed a motion in the SCC for a re-hearing of the appeal given the two opposite interpretations of the Act. In February 2024, the SCC denied the City’s motion for re-hearing, without reasons. That means, the SCC decision will stand and remain the law in Ontario. Therefore, unless the Act is amended, the term “employer” in the Act will be broadly interpreted and all employers on a project site have responsibility to ensure compliance with the safety requirements under the Act.

This decision creates challenges and complexity for project owners and all industry participants working on construction projects, where multiple employers are often found. A practical consequence of Sudbury is that project owners may be found to be an “employer” under the Act by reason of engaging a contractor for a construction project, even though the contractor has the obligations of a “constructor”. Obviously, this may impose additional risks and create unintended consequences for owners and project

developers. It also raises questions about the scope of owners’ responsibility under the Act, the role of the “constructor”, and the responsibility of employers. Further, the requirements for owners to meet the due diligence test are not yet clear but will be something that owners will need to consider carefully.

This decision exemplifies the view of Canadian courts that protecting worker safety is of paramount importance. The SCC interpreted the Act as creating overlapping and concurrent responsibility for safety, making multiple industry participants responsible for worker safety, even when it had been contractually delegated. While the Sudbury case is based on the Ontario legislation, occupational health and safety legislation in other provinces across the country may face similar scrutiny and interpretation.

Tendering: The Importance of the Word “Low” in the Expression “Lowest Compliant Bidder”

In Canadian law, both in the common law provinces and in the civil law regime prevailing in Quebec, owners are not necessarily obligated to award contracts according to the “lowest compliant bidder” rule. All jurisdictions provide the opportunity for owners to include clauses in tender documents which grant them a certain degree of discretion (which must always be used in a reasonable manner), allowing the contract to be awarded to a compliant bidder who is not the lowest bidder (*M.J.B. Enterprises Ltd. v Defense Construction (1951) Ltd.*, [1999] 1 SCR 619).

However, either the tender documents or specific statutes may stipulate that the contract will be awarded to the lowest compliant bidder. In the absence of clear language in either of these two approaches, the courts may view the tender documents, depending on the circumstances, as

Contributed by: Trish Morrison KC, Simon Grégoire, James MacLellan and Michael Skene,
Borden Ladner Gervais LLP

including an implicit condition that the contract will be awarded to the lowest compliant bidder. Whether this obligation is explicit or implicit, case law has long established that a contracting authority will not be able to avoid its obligation to award the contract to the lowest compliant bidder when a “non-conformity” in the lowest bidders’ tender submission is only “minor”. As a result, a substantial body of jurisprudence has developed on the notions of “major” versus “minor” non-conformities.

In Quebec, the lowest compliant bidder rule is found in several acts and regulations relating to the award of contracts by public owners, such as the Cities and Towns Act, the Regulation respecting certain supply contracts of public bodies, the Regulation respecting service contracts of public bodies and the Regulation respecting construction contracts of public bodies.

This reality explains why Quebec courts have rendered several decisions addressing the “lowest compliant bidder” rule and, consequently, discussing the nature of non-conformities, namely whether a non-compliance is major or minor. This abundant case law makes it possible to expound at length on the various criteria which distinguish the major and minor non-conformities and the basis upon which a non-conformity that can be corrected without affecting the tender price will often be regarded as “minor”.

A recent decision by the Court of Appeal also reminds us that even before considering these criteria, the lens through which this examination of non-conformities must be carried out is that of the interest of taxpayers, which means, in the opinion of the court, the lowest price. Therefore, the more importance this overriding interest of

taxpayers is given, the more serious a non-compliance will have to be in order to be classified as “major” and thus justify the decision not to award the contract to the lowest bidder.

In a context where the owner was a federal Crown corporation, the Quebec Court of Appeal recently emphasised in *Defense Construction Canada v Atwill-Morin Group Inc.*, 2024 QCCA 319 (CanLII) the importance of the word “low” in the “lowest compliant bidder” rule. The Court of Appeal upheld the first instance decision that the alleged non-compliance for the rejection of the lowest bid was minor and that therefore the bid of the contractor should not have been rejected. The Court of Appeal added that (our translation) “it was in the public interest for the appellant to accept the respondent’s bid, which was the lowest bid, not because of its obligation to the lowest bidder, but to the public treasury, which should never be required to pay, for no good reason, a higher price than necessary...”. The Court of Appeal thus emphasised the importance of the lowest price in analysing the conformity of a bid and reminded us what was said in a prior decision that (our translation) “[b]efore rejecting the lowest bid, which will be the least costly for the public who pays the bill, the Tribunal must show great caution and only call into question the award of the contract to the lowest bidder in the obvious cases, the serious cases, where it involves an irregularity on an essential element”. (*SPECS Audio (1990) Inc. c. Centre de services partagés du Québec*, [2009] QCCS 5705).

Trends in Canadian Surety Law

Surety law in Canada has undergone significant updates over the years, reflecting changes in society, commerce and legal principles. From its roots in common law, Canadian surety law has evolved through legislative reforms, judicial

Contributed by: Trish Morrison KC, Simon Grégoire, James MacLellan and Michael Skene,
Borden Ladner Gervais LLP

decisions and the adaptation of international standards.

Historically, surety law in Canada was primarily governed by common law principles inherited from English legal traditions. These principles emphasised the importance of contract interpretation, good faith dealings and equitable remedies. However, as commercial transactions became more complex and international in scope, the need for a modernised legal framework became apparent.

This modernisation of surety law in Canada has also been driven by technological advancements and digitalisation trends. Electronic bonds, digital signatures, and online platforms have simplified the process of issuing, managing and enforcing surety instruments. These technological innovations have improved efficiency, reduced paperwork and enhanced accessibility for stakeholders in the surety ecosystem.

Some of the most notable recent decisions in Canadian surety law are set out below.

Wolverine Construction Inc. v Trisura Guarantee Insurance Company, 2023 BCSC 405

This British Columbia case dealt with the issue of whether a signed contract was necessary to advance a claim under a payment bond. The payment bond required that there be a direct contract with the principal for the supply of labour and materials to the bonded contract. The plaintiff was seeking that the court infer a contract existed from the surrounding facts. After examining the facts, the court concluded that there were not sufficient facts to conclude that a direct contract existed and therefore the plaintiff did not meet the definition of a claimant

under the payment bond. The action was therefore dismissed against the surety.

Edward Collins Contracting Limited (Re), 2023 NLSC 139

This case, in Newfoundland and Labrador, dealt with the issue as to whether, in the context of a Company Creditors Arrangement Act (CCAA) proceeding, a court could provide a release to an indemnitor of a surety in order to facilitate a sale of the debtor to a related party. In reliance on Section 11 of the CCAA, which provides the court with broad jurisdiction to make any order that it considers appropriate in the circumstances, the court granted the release. The court was influenced by the fact that unless the sale took place a considerable number of jobs would be lost. Ordering the release was therefore the balancing of the equities required under the CCAA legislation.

Bird Construction Group v Trotter and Morton Industrial Contracting Inc, 2023 MBCA 64

In this case, the Manitoba Court of Appeal overturned the decision of the application judge and ruled that lien bonds could be used as security to vacate claims for lien on Crown lands. In doing so, the Court of Appeal provided much needed clarity on the use of lien bonds on construction projects. The application judge's decision had diminished the utility of lien bonds by creating uncertainty about whether lien bonds would be adequate security in certain circumstances. However, the Court of Appeal's reversal of the application judge's decision has restored clarity on the utility of lien bonds as the preferred means of security to vacate liens and "ensuring payment of contractors and subcontractors and encouraging liquidity in the flow of funds".

Looking ahead, the future of surety law in Canada is likely to be shaped by ongoing trends in

CANADA TRENDS AND DEVELOPMENTS

Contributed by: Trish Morrison KC, Simon Grégoire, James MacLellan and Michael Skene,
Borden Ladner Gervais LLP

globalisation, digitalisation and sustainability. Continued collaboration between government, industry, and legal stakeholders will be essential to address emerging challenges and seize new opportunities in the dynamic surety landscape. By staying abreast of international developments, embracing technological innovations and promoting ethical business practices, Canada can maintain its position as a leader in surety law and contribute to the advancement of global surety standards.

CHILE



Trends and Developments

Contributed by:

Juan Pablo Halpern, Nathaniel Horrocks-Burns and David Meza
Clyde & Co

Clyde & Co is a leading global law firm with more than 2,400 lawyers operating from over 60 offices and associated offices on six continents. The Santiago office has in-depth expertise in advising contractors, developers, owners and engineers in the Latin America region. Its combination of sector expertise, a commercial attitude and in-depth regional understanding ensures clients benefit from a unique perspective. Clyde & Co acts for clients at all levels of the supply chain. Through the firm's diverse

sector experience, the global projects and construction group has strength and first-hand understanding of the dynamic nature of the infrastructure and energy market. It supports clients across the full life cycle of projects worldwide, from planning to constructing, developing and operating, through to refinancing, sale and decommissioning. The team advises on commercial and contractual issues, risk management, claims avoidance, dispute resolution, litigation and arbitration.

Authors



Juan Pablo Halpern is a partner in Clyde & Co's Santiago office and heads the Chile offering of the global projects and construction group. He is a highly regarded construction law

specialist in Latin America and provides contract drafting and strategic project advice for high-value complex projects, as well as dispute resolution. With 20 years of practice in the field, he has experience in all forms of construction contracts in a wide range of sectors in Chile and in Latin America, including DB, BOT, EPC/TK and EPCM contracting. He recently advised a Canadian mining company on the development of two major infrastructure projects in Chile.

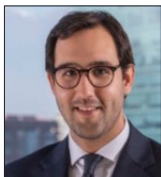


Nathaniel Horrocks-Burns is a legal director in Clyde & Co's global projects and construction group, based in the London office, with experience in handling complex matters

relating to construction and engineering projects. He handles both contentious and transactional matters relating to construction and engineering projects in the UK and internationally, with a particular focus on international arbitration and complex dispute work. He has extensive dispute resolution experience, covering adjudication, litigation and international arbitration (including under ICC, LCIA, SIAC and CIETAC rules) and a range of ADR procedures, including expert determination and mediation.

CHILE TRENDS AND DEVELOPMENTS

Contributed by: Juan Pablo Halpern, Nathaniel Horrocks-Burns and David Meza, **Clyde & Co**



David Meza is a senior associate in Clyde & Co's Santiago office and has extensive experience in advising owners, sponsors, EPC contractors and state-owned

companies on international construction claims and disputes in the mining, infrastructure and energy sectors. David's practical experience includes serving as an in-house counsel for two of Latin America's largest construction companies, where he handled disputes arising from EPC contracts for major infrastructure projects across Colombia, Peru, and Mexico. He has acted in several arbitration cases under ICSID, PCA, and ICC rules, and is currently focused on defects disputes arising from critical solar and wind energy projects in Chile.

Clyde & Co

22nd Floor, Orinoco 90 Las Condes
Santiago C.P. 7560970
Chile

Tel: +56 224990400
Email: info@clydeco.cl
Web: www.clydeco.com

CLYDE & Co
CHILE

The Role of Modern Contracting Methods in Support of Chile's Energy Transition

Overview

Over three-quarters of greenhouse gas emissions in Chile are attributed to the energy sector. Chile has embarked on an ambitious journey towards energy transition, highlighted by its commitment to combat climate change and promote sustainable growth.

After recognising the crucial role of the energy industry in environmental sustainability, Chile is pushing towards a greener energy matrix, by means of robust regulatory reforms and significant infrastructural upgrades. At the centre of these infrastructural upgrades is the construction of new energy sources and the expansion of the transmission grid.

Transmission as a sustainability pillar

Chile's approach integrates a comprehensive institutional framework to achieve greenhouse gas emission neutrality by 2050. Key areas identified for improvement include:

- renewable and clean electrical generation;
- electromobility enhancements;
- energy efficiency initiatives; and
- the development of green hydrogen technologies.

These goals require important modifications across various sectors, with a special focus on the expansion of the transmission grid to support a renewable energy-led infrastructure.

Significant regulatory changes have been implemented over the past decade, with the most crucial updates enacted through the 2016 Transmission Law (Law No 20.936). This law revised the General Law of Electrical Services to promote increased competition and support the

growth of renewable energy, marking a pivotal shift in how electrical transmission is managed and expanded.

Current challenges to transmission line expansion projects

As Chile continues to navigate the complexities of its energy transition, legislative advancements play a crucial role. The Chilean Congress is currently debating the Energy Transition Bill which is aimed at further refining the regulatory landscape to facilitate smoother and more effective infrastructural developments. The bill proposes:

- more precise accountability mechanisms for project bidding and execution;
- revised investment valuation processes to adapt to real-time financial dynamics during project implementation; and
- enhanced roles and responsibilities for private owners and operators in managing tender processes and project executions.

The legislative process of the Energy Transition Bill begins with its first constitutional procedure in the Senate, where it undergoes debate and voting. If passed, the bill progresses to the Chamber of Deputies for further consideration. This procedural path ensures that the bill is scrutinised at every stage, allowing for modifications that align with the evolving needs of the energy sector and the interests of a variety of stakeholders.

Under the current legislation, the tender and contracting process for the transmission lines expansion works is solely led by a government authority called the National Grid Co-ordinator, which oversees the development of the design studies and drafting of the bidding documents for each project. Rather paradoxically, despite aiming to achieve more transparent and cost-

efficient projects, the National Grid Co-ordinator has historically drafted very stringent EPC contracts, creating the following obstacles:

- high costs associated with expansion bids, often significantly exceeding reference prices;
- the frequent occurrence of deserted tender calls, indicating potential inefficiencies or a lack of attractiveness of the projects; and
- delays and conflicts in the execution of awarded expansion projects.

These issues highlight the complexities involved in upgrading Chile's transmission infrastructure – a critical element in the nation's decarbonisation strategy.

Under the new legislation, the role of the National Grid Co-ordinator would be limited to reviewing the terms of the tenders prepared by the owners, requesting any necessary changes, and overseeing free competition during the bidding process.

The bill also introduces a mechanism to review the contract price for which the expansion work was awarded, but only if there have been substantial changes that are not attributable to the contractor.

The inclusion of transitional rules for existing expansion projects underscores the bill's comprehensive approach to addressing ongoing challenges with the bidding and construction of these kinds of projects.

By changing the approach from public to private and from traditional to more modern delivery models, the bill facilitates the implementation of modern contracting methods, such as alliancing and collaborative delivery models.

Collaborative contracting models for transmission line expansion projects

Collaborative models seek to align the interests of all project participants, to encourage them to work together for the benefit of the project. This is in stark contrast to traditional contracting models, under which project participants tend to prioritise their own interests over and above those of the project and/or others.

There are many different collaborative models, which incorporate key principles associated with collaborative contracting to different degrees.

There are no fixed definitions of the terms “collaborative contract”, “partnering contract” and “alliancing contract”, and these terms can be used interchangeably, with different people using the terms differently. For the purposes of this article, however, partnering contracts tend to be based on standard form contracts that incorporate collaborative elements but where each partner retains its independence and may individually incur benefits or losses. In contrast, alliancing contracts tend to require higher degrees of collaboration and risk sharing, with the intention being that all parties forming part of the alliance jointly share the risks and rewards.

Collaborative contracts can be either bilateral or multi-party. Multi-party contracts tend only to be used where a high degree of collaboration and risk-sharing is required amongst several partners, and they are therefore typically more often seen in alliancing arrangements.

The agreements that underpin these different arrangements take a variety of different forms; some are based largely on standard form contracts, with others operating under much more bespoke contractual frameworks. Collaborative contracts tend to include a range of mecha-

nisms, tools and procedures aimed at driving collaborative behaviours in all project participants for the benefit of the project, including:

- express contractual obligations to co-operate and act in good faith;
- early warning mechanisms to promote proactive project and risk management, encouraging contemporaneous information sharing amongst project participants with a view to working collaboratively to mitigate and find solutions to issues that arise during construction;
- appropriate governance arrangements to encourage proactive monitoring of progress and joint decision making, and “real time” resolution of claims as they arise;
- requirements to re-locate teams to promote team members working as one team;
- payment mechanisms that operate to motivate and incentivise all project participants to work together for the benefit of the project, and can be linked to the achievement of agreed Key Performance Indicators (KPIs) or go further and impose a pain/gain share mechanism linked to the achievement of cost and/or programme targets – they are more likely to be based on a cost plus profit percentage payment model rather than fixed lump sum; and
- “no fault” clauses whereby project participants mutually release liability for breach of contract/negligence.

Not all collaborative contracts incorporate all these features, and it is important for the parties to choose a contracting model and contract terms that align with the degree of risk sharing and co-operation that they are comfortable with.

The advantages and disadvantages of collaborative contracting will depend on which model

is selected, and in particular the degree of collaboration and risk sharing involved. Some of the potential benefits of successful collaborative contracting are outlined below, as well as some of the potential risks and disadvantages.

Potential advantages/opportunities of collaborative contracting models

Increased innovation and efficiency

A fairer apportionment of risk and liability, agreement on project objectives, and alignment of commercial interests can motivate (and appropriately incentivise) project participants to work collaboratively and take risks in pursuit of greater efficiency. If doing so benefits the project, it should (in theory) benefit all participants and lead to greater potential for projects to be delivered in line with time, cost and quality objectives.

Increased integration and flexibility and ability to innovate

A multi-disciplinary project team comprising design specialists, contractors and suppliers can work together at an early stage, share information to plan and scope the design and implementation of the works, and identify/resolve potential “buildability” issues, reducing the need for costly and disruptive changes during construction. An integrated project team can also work collaboratively to find design and technical solutions to complex and/or unanticipated issues that arise during the course of the project.

Contemporaneous risk management and governance

Risks can be identified and managed jointly by project participants at an early stage, and appropriate governance arrangements can help project participants to collaboratively make the decisions necessary to mitigate potential time, cost and quality impacts.

Fewer disputes (or disputes that need to be resolved by formal dispute resolution procedures)

There is potential to reduce the legal and administrative project costs associated with disputes through better conflict resolution and dispute avoidance procedures that seek to resolve differences in a non-adversarial manner as and when they arise and before they become disputes (eg, dispute board), and/or more limited rights to bring claims against other project participants (eg, a mutual waiver of contractual rights, or project insurance and agreements to share uninsured risks).

Potential disadvantages/risks of collaborative contracting models

More limited control

Collaborative models require owners to relinquish control of the project and to share decision-making powers with other project participants.

Increased administrative burden

Compared with traditional contracting models, the successful implementation of a collaborative model requires a much more significant investment of time, costs and resources into the joint administration of the contract throughout its lifespan to ensure that the project/risk management and decision-making mechanisms, processes and procedures associated with the model are properly implemented.

Impact of organisational/market instability

All participants must embrace and maintain a collaborative approach at all levels (including up to senior management). The success of longer-term collaborative arrangements can therefore be undermined by organisational changes (eg, replacement of senior personnel) and/or economic shocks (eg, recession) that cause par-

ticipants to abandon collaborative principles in favour of a more adversarial approach.

Limited recourse against non-performing parties

A model under which participants have more limited contractual rights to bring claims against others can be problematic (eg, under a model where project participants mutually release liability to each other, they may have limited recourse against a participant who fails to perform in accordance with the contract, unless such failure amounts to wilful misconduct or fraud).

Project insurance

Traditional insurance policies may not be compatible with collaborative models where participants agree to limit their legal recourse against one another, as this limits insurers' prospects of pursuing subrogated recovery actions. Bespoke project insurance products designed specifically for collaborative contracting models are therefore required and can be more expensive.

What makes a contract "collaborative"?

An issue that should be highlighted is that in collaborative contracts it is not simply a question of adapting traditional contractual forms and inserting clauses that impose duties of co-operation or acting in good faith, as these duties are already understood to be incorporated into contracts, at least in civil law legal systems like Chile's.

A contract must involve a structure of shared governance and distribution of risks (costs and profits) that differs from the traditional model in order to be considered collaborative. The design takes place by involving all relevant parties (eg, engineer, builder and principal) at an early stage of the project.

Likewise, the remuneration obtained by the participants in a collaborative contract is linked to the achievement of the project's objectives. Although the formulations vary, usually all or part of the profits of the participants are related to a risk pool, from which the profits will be shared (by reason of meeting or exceeding the performance of the project) or that can be used to cushion the cost overruns. The logic applicable is that the benefit of each participant is not a function of the amount of work done or individual productivity but is proportional to the overall success of the project.

That is why, for example, regardless of the many declarations of co-operation, good faith and "friendly" dispute resolution mechanisms that are made in a contract where the price has been agreed as a simple lump sum, said contract can hardly be qualified as "collaborative".

Key success factors and common pitfalls of collaborative contracting models

In many ways, collaborative contracts are more about the way the parties interact than the detail of the contract terms. A failure to properly understand and/or properly engage with the contractual arrangements underpinning a collaborative model by either the owner or the contractor can undermine the success of the project. If one party attempts to operate the collaborative contract as if it were a traditional contract, or acts in an adversarial way, this will quickly lead to a breakdown of trust in the relationships between the participants, which are so crucial to the success of the model.

Collaborative contracting models tend to be more successful where all parties commit fully to the philosophy of collaborative contracting, embrace the underlying principles and adopt a collaborative mindset. It is important that this

is maintained throughout the project. If initial enthusiasm and commitment wane over time, this can lead to a breakdown of trust in the relationships between the project participants and undermine the success of the project.

Collaborative contracts require a great deal of management time and resource throughout their lifetime if they are to succeed, because issues must be tackled as they arise rather than being left to the end of the project. There is a greater chance of success where participants ensure that their project teams are adequately resourced, and suitably experienced, to operate the various contractual mechanisms incorporated into collaborative contracts to help develop and maintain collaborative relationships between them (eg, project and risk management processes, governance procedures and dispute resolution mechanisms).

It is important to agree objectives for the project at the outset that provide for mutually beneficial outcomes for all participants, and that they be quantifiable and measurable to help encourage behaviours consistent with the collaborative model. These should be closely monitored to check they remain relevant to the project and can be an effective means of driving desired behaviours amongst the participants.

It follows, then, that the later in a project's lifecycle a decision to adopt a collaborative approach is adopted, the less likely it will be to succeed, as it becomes more difficult to agree and implement an incentives regime that will reward the project outcomes that are required and more difficult for the project participants to adopt the collaborative mindset and project management procedures that are needed to make the collaborative approach succeed.

Implications for the future

Through these legislative reforms, the government is driving forward the economic and environmental sustainability of Chile's energy infrastructure. The ongoing legislative efforts are expected to streamline new contracting methods, such as alliancing and collaborative models, for the transmission line expansion projects. By addressing the technical and financial asymmetries in the traditional delivery systems, these developments are likely to bolster investor confidence by enhancing collaboration and efficiency.

As these reforms take shape, they promise to significantly impact the overall economic viability of the nation's energy infrastructure, thus accelerating the pace of Chile's energy transition and ensuring that the country meets its ambitious 2050 goals.

CHINA

Law and Practice

Contributed by:

Hong Lu, Ping Zhang, Xiaoxia Zhang and Ping Xiang
Merits & Tree Law Offices

Contents

1. General p.157

- 1.1 Governing Law p.157
- 1.2 Standard Contracts p.158

2. Parties p.158

- 2.1 The Employer p.158
- 2.2 The Contractor p.159
- 2.3 The Subcontractors p.160
- 2.4 The Financiers p.160
- 2.5 The Designer p.161

3. Works p.161

- 3.1 Scope p.161
- 3.2 Variations p.162
- 3.3 Design p.163
- 3.4 Construction p.163
- 3.5 Site p.163
- 3.6 Permits p.164
- 3.7 Maintenance p.164
- 3.8 Other Functions p.164
- 3.9 Tests p.164
- 3.10 Completion, Takeover and Delivery p.164
- 3.11 Defects and Defects Liability Period p.165

4. Price p.166

- 4.1 Contract Price p.166
- 4.2 Indexation p.166
- 4.3 Payment p.167
- 4.4 Invoicing p.167

5. Time p.167

- 5.1 Planning and Programme p.167
- 5.2 Delays p.168
- 5.3 Remedies in the Event of Delays p.168
- 5.4 Extension of Time p.168
- 5.5 Force Majeure p.169
- 5.6 Unforeseen Circumstances p.169
- 5.7 Disruption p.169

6. Liability p.170

- 6.1 Exclusion of Liability p.170
- 6.2 Wilful Misconduct and Gross Negligence p.170
- 6.3 Limitation of Liability p.171

7. Risk, Insurance and Securities p.171

- 7.1 Indemnities p.171
- 7.2 Guarantees p.171
- 7.3 Insurance p.172
- 7.4 Insolvency p.172
- 7.5 Risk Sharing p.172

8. Contract Administration and Claims p.173

- 8.1 Personnel p.173
- 8.2 Subcontracting p.173
- 8.3 Intellectual Property p.174

9. Remedies and Damages p.174

- 9.1 Remedies p.174
- 9.2 Restricting Remedies p.174
- 9.3 Sole Remedy Clauses p.175
- 9.4 Excluded Damages p.175
- 9.5 Retention and Suspension Rights p.175
- 9.6 Termination p.175

10. Dispute Resolution p.176

- 10.1 Regular Dispute Resolution p.176
- 10.2 Alternative Dispute Resolution p.176

Merits & Tree Law Offices has a real estate and infrastructure team led by four key partners and more than ten supporting partners, in addition to over 20 lawyers. The team provides contentious and non-contentious legal services in the sector, including construction and engineering of buildings and infrastructure, real estate development and sales, land acquisition, project mergers and acquisitions, urban renewal, property management and operation, project invest-

ment and financing, project tax planning and asset-backed securitisation. The lawyers advise local giant real estate developers as well as various construction companies in China, such as Vanke, Longfor and Greentown. The team provides strategic and professional solutions to clients on contract negotiation, bidding and tendering, construction claims and disputes, and on-demand guarantee-related matters.

Authors



Hong Lu is a partner at Merits & Tree Law Offices. His practice and experience focus on legal services in real estate and infrastructure. He is an expert in dispute resolution regarding risk

control, and in connection with construction projects, including strategy making, business negotiation, identification of potential risks and provision of resolutions. Mr Lu was one of those who drafted the Operating Guidelines for Lawyers Handling Construction Project Cases issued by the All China Lawyers' Association, and has been awarded as the Highly Recommended Lawyer of the Engineering Industry by ENR/Construction Times multiple times. Mr Lu also serves as arbitrator at several arbitration institutions.



Ping Zhang is a partner at Merits & Tree Law Offices. Her practice focuses on construction and infrastructure, real estate transactions and complex commercial dispute resolution.

In the past 30 years, Ms Zhang has gained extensive experience in providing legal services for SOEs, leading real estate enterprises, government departments, urban investment companies, and financial bureaus in construction, real estate development and commercial property operation, bulk property transactions, M&A, PPP and concession, land replacement, government bonds and urban renewal projects. She is currently the deputy director of Hubei Lawyers Association Construction Real Estate Law Professional Committee, arbitrator of Wuhan Arbitration Commission, Jingmen Arbitration Commission and Shijiazhuang Arbitration Commission.



Xiaoxia Zhang is a partner at Merits & Tree Law Offices. She focuses on legal services and research in the field of real estate and infrastructure and has been involved in a number of infrastructure and commercial real estate projects, including development and financing, construction and dispute resolution, housing, municipal, petrochemical, civil aviation, new energy and so on. In addition, she has served as an arbitrator and an adjudicator at many well-known arbitration institutions in Beijing, Shanghai, Shenzhen, Guangzhou and other places, and has rich experience in arbitration cases related to real estate and construction projects.



Ping Xiang is a partner at Merits & Tree Law Offices and is dedicated to providing legal services in the field of real estate and infrastructure, including full process non-litigation consulting and dispute resolution legal services for real estate investment, construction, and operation management. Mr Xiang has provided specialised consulting services and litigation/arbitration agency services throughout the investment, construction, and operation process for multiple commercial residential development projects, bank headquarters building projects, pharmaceutical research and development bases, port terminal expansion projects, industrial park renewal projects, local financial centre landmark projects, and highway projects.

Merits & Tree Law Offices

Unit 1801
Raffles City Changning Office Tower 1
No 1133 Changning Road
Changning District
Shanghai 200051
People's Republic of China

Tel: +86 21 5253 3500
Fax: +86 21 5253 3599
Email: zheyuan.jin@meritsandtree.com
Web: www.meritsandtree.com



1. General

1.1 Governing Law

Legal System

As a civil law country, legislation is a major source of Chinese law. The hierarchy of legislative instruments is roughly as follows:

- the constitution passed by the National People's Congress (NPC);
- national laws passed by the NPC or its standing committee;
- administrative regulations enacted by the State Council (the supreme administrative body in China); and
- the implementation of administrative regulations issued by ministries and commissions of the State Council, local laws passed by the local People's Congresses or their standing committees, and regulations issued by local governments.

Principal Laws Governing the Construction Market

Primary national laws governing the construction sector include:

- the [Civil Code of the People's Republic of China](#) (PRC);
- the Bidding Law of the PRC (2017 Amendment);
- the Construction Law of the PRC (2019 Amendment);
- the Urban and Rural Planning Law of the PRC (2019 Amendment); and
- the Law of the PRC on Environmental Impact Assessment (2018 Amendment).

The Supreme People's Court (SPC) issued a judicial interpretation on issues concerning application of the law in construction contract disputes on the basis of the Civil Code on 29

December 2020 and the interpretation has been in force since 1 January 2021.

Moreover, several administrative regulations by the State Council deal with key aspects of the administrative side of construction practice, including:

- the Regulation on the Implementation of the Bidding Law of the PRC (2019 Revision);
- the Regulation on the Quality Management of Construction Projects (2019 Revision);
- the [Regulations on Environmental Protection Management for Construction Projects \(2017 Revision\)](#);
- the Regulation on the Work Safety of Construction Projects; and
- the Regulation on the Administration of Survey and Design of Construction Projects (2017 Revision).

Various implementation rules of administrative regulation issued by the Ministry of Housing and Urban-Rural Development (MOHURD), the National Development and Reform Commission (NDRC) and other ministries also play a relatively important role, providing detailed and practical rules on construction practice, such as:

- the Provisions on Engineering Projects Which Must Be Subject to Bidding;
- the Measures for the Administration of Bidding for the Construction of the House Building and Municipal Infrastructure Projects; and
- the Measure for the Administration of EPC of the House Building and Municipal Infrastructure Projects.

Mandatory national standards approved and promulgated by the State Council are the technical and detailed support of the law. Enterprises that do not comply with the technical require-

ments of the publicised standards shall bear civil liability, be included in the creditworthiness records or bear criminal liability. Mandatory national standards must be implemented and play a relatively important role, providing detailed and practical rules on construction practice, such as:

- the Standards for qualification of construction enterprises; and
- the Code of valuation with bill of quantity of construction works.

1.2 Standard Contracts

Model Contracts

There are certain model contracts available for parties to use on domestic projects in the construction market. Although such use is not mandatory, the terms of these contracts reflect a reasonable allocation of risks and capture good practice, so parties usually adopt these model contracts with amendments on specific projects. Alternatively, parties may design bespoke contracts from scratch or may use the FIDIC (International Federation of Consulting Engineers) forms with amendments on some projects involving unique or foreign elements.

These model contracts are jointly issued by MOHURD and the State Administration for Market Regulations or the State Administration for Industry and Commerce and may be revised or amended as necessary. The latest versions of some major model contracts are as follows:

- the Model Subcontract Contracts (GF-2003-0213/0214) between a contractor and a subcontractor;
- the Model Engineering Contract for Construction Projects (GF-2015-0209/0210) between an employer and an engineering designer;

- the Model Cost Consultation Contract for Construction Projects (GF-2015-0212) between an employer and a consultant;
- the Model Survey Contract for Construction Projects (GF-2016-0203) between an employer and a surveyor;
- the Model Contract for Construction Works (GF-2017-0201) between an employer and a construction contractor; and
- the Model Contract for General Contracting Projects (GF-2020-0216) between an employer and a general contractor.

Standard Bidding Documents

On 20 December 2011, nine ministries and commissions jointly issued the Short Form of Standard Construction Bidding Documents and the Standard Bidding Documents for Design-Construction Integrated Projects, which took effect on 1 May 2012. For projects that must by law be subject to the bidding process, parties are required to mandatorily use these two standard bidding documents, which include instructions for tenders, bid evaluation and general contract terms.

2. Parties

2.1 The Employer

The employer commissions works in a construction project and is typically the holder of the right to use construction land. An employer may take different forms, such as a variety of companies, institutions and even a natural person, depending on the nature and type of project.

Rights and Obligations

In general, prior to entering into a contract, the employer has the right to determine a suitable project contracting mode and to select a quali-

fied contractor following legal requirements and procedures (if applicable).

The employer's rights and obligations vary depending on the nature and scope of the construction contract.

Typically, the employer has the right:

- to appoint its own representatives or entrust an engineer/supervisor to supervise site works and inspect the contractor's completed works, on the condition that there is no disruption to the contractor's work; and/or
- to terminate the contract on the basis of illegal subcontracting, etc.

On the obligation side, the employer is typically required:

- to obtain approval to use the construction land, and to obtain planning approval for the construction land and construction project, as well as the permit for the construction works;
- to assist the contractor with the contractor's applications for any permits and certificates;
- to give the contractor right of access to the site, to provide site conditions and information, and basic materials to the contractor;
- to effect payment as agreed;
- to organise tests and acceptance of the works upon completion; and
- to file project documents and records with the local authorities.

Relations Between the Employer and Other Key Players

The employer and the contractor are parties to the construction contract, the terms of which are contractually binding as agreed. As to actual subcontractors in a scenario of illegal subcontracting, the employer might have legal respon-

sibility to pay them directly, provided such payment is within the employer's due and payable amounts to the contractor. Depending on modes of project financing, the financier can be the employer, or the employer's shareholder.

2.2 The Contractor

The contractor carries out the works in a construction project and has the principal responsibility for completing the works. The contractor must have corresponding qualifications for undertaking the works and is not allowed to work beyond the scope and level of its qualification(s). Likewise, the company acting as contractor may take different forms but may not be a natural person. Complex projects are commonly undertaken by a joint venture.

Rights and Obligations

The contractor's role and responsibilities vary depending on the type of construction contract. The contractor has a typical right to be paid, to seek preferred payments of compensation for the unpaid amounts if the project quality is qualified and to claim for extension of time or costs if delays are caused by the employer. The contractor's general obligations include:

- executing and completing works within the agreed scope of the work and meeting technical standards and requirements;
- remedying defects within the defects notification period;
- assuming warranty obligations within the statutory periods;
- taking measures to ensure site safety and environmental protection;
- obtaining permits and certificates as necessary for construction works; and
- co-operating with the supervisor or engineer as entrusted or appointed by the employer.

Relations Between the Contractor and Other Key Players

If the contractor elects to subcontract part of the works to a subcontractor, the contractor and the subcontractor are both parties to the subcontracting contract. The contractor and subcontractors are jointly liable to the employer for the quality and safety of the works subcontracted.

2.3 The Subcontractors

It is very common in practice for the contractor to subcontract part of the works. Subcontractors are divided into two types: specialist subcontractor and labour subcontractor. A subcontractor is only allowed to undertake works within the scope and level of its qualification. Subcontracting works must also comply with legal and contractual requirements. Specifically, the contractor is restricted from subcontracting the entirety of the works to subcontractors. Illegal subcontracting may trigger the application of a series of legal consequences and the actual constructor may file a lawsuit against the employer directly for the construction project price.

Rights and Obligations

Subcontractors share similar rights and obligations with the contractor for works subcontracted. A “pay if paid” or “pay when paid” clause is often seen in a subcontractor’s contract, meaning that the subcontractor’s right to payment under its contract may be subject to the contractor’s entitlement to payment under the main construction contract. The legal effects of such clause are in dispute in court practice. Subcontractors have no right to file a lawsuit against the employer directly, unless the contractor is negligent in exercising the creditor’s right that is due or the collateral right related to the creditor’s right, thus affecting the realisation of the creditor’s right that is due.

2.4 The Financiers

In traditional construction practice, the employer may raise funds on its own and the financiers would then be banks, financial institutions, shareholders or the employer itself. For government investment projects, the project funds would come from the financial budget of local or central governments. This traditional financial arrangement has changed in recent years and the contractor may also now participate as a financier. By way of example, in the creative PPP+EPC (Public-Private Partnership + Engineering, Procurement and Construction) model, the contractor may participate in project financing and also construction works, acting in the dual roles of investor/financier and constructor.

Rights and Obligations

The financier has the right to supervise the account of the project company, require the employee or the project company to mortgage the construction in progress and pledge the equity. There are many factors to consider in the guarantee setting, including whether the financier’s exercise of power affects the project operation, whether it triggers the termination of the commercial contract, etc. It is necessary to balance the interests of the financier and the project company. To take account supervision as an example, the financier hopes to control income and control dividends so that priority can be given to repayment of excess funds; the employer hopes to retain control and dividends payment. The failure to balance may lead to project cash flow problems, which will adversely affect employers and financiers.

Relationship

Contractors and subcontractors play an important role in the construction of the project, and their credit is also one of the important factors for the financiers to consider in deciding whether

to provide finance. The financier, the employer, the contractor and the subcontractor form a project team by entering into various agreements and are the relevant parties of the project. By taking into account the interests of all parties, and through sound co-ordination, parties can achieve a reasonable sharing of risks and an amicable resolution of conflicts.

2.5 The Designer

According to the Construction Law of the PRC, the construction designer is required to hold a qualification of design issued by the MOHURD. Such qualifications are classified into different categories to include general construction and specific industries (eg, chemical engineering, energy, railway, etc), as well as different levels depending on the scales of projects. The MOHURD will update the qualification rules every five to ten years.

Most of the holders of the qualifications are state-owned designing institutes, among which many are attached to state-owned contractors, universities or governmental departments. However, in the past 20 years, many private companies have competed with state-owned institutes by obtaining more comprehensive qualifications and by establishing a more flexible business model. There are many foreign-invested studios led by overseas architects playing an important role in the high-end projects such as city landmarks and avant-guard complexes. However, they have to co-operate with a qualification-holder so that the official design work is produced under the name of the qualified institute.

Rights and Obligations

The rights of the designer under a common contract are not overwhelming. The designer must follow the instructions of the project owner regarding the technical specifications of the pro-

ject, although mostly the project owner will leave the designer much discretion for the details of the design work.

In common practice, the design drawing is not deemed to be the intellectual property of the designer, for the reason that the drawing work is paid for and purchased by the project owner.

The designer is not allowed to designate any specific brand or producer of the construction materials in the drawing. However, the designer may recommend a range of brands or a grade of the reputation of the producer to the project owner.

It is the designer's obligation to follow the national standards of construction quality and safety. The main design engineer of the project shall be personally responsible for the quality and safety of the project for its designed life.

Relationship

In a general construction contracting model, the designer and the contractor will have separate and independent contractual relationships with the project owner. Therefore, they will have to inter-relationship. If there is any design mistake to correct or optimisation to apply, the general contractor will report to the project owner, and the project owner will then consult the designer for further decision.

3. Works

3.1 Scope

A typical construction contract is formed of several documents, listed below in order of priority:

- contract agreement;
- particular conditions;

- general conditions;
- technical standards and requirements;
- drawings;
- bill of quantities or budgets; and
- any other documents forming part of the construction contract.

The scope of the works is firstly described in the contract agreement in a general way. Then particular conditions and general conditions may provide a brief description of the scope of the works by referring to drawings and bills of quantities. Finally, drawings and bills of quantities supply more details. Sometimes, certain project items will be additionally defined in terms of technical standards and requirements.

In fact, for projects procured through a bidding process, both the employer and contractor may determine and settle the scope of the works in a letter of award and a letter of tender and its schedules. Specifically:

- the employer may include drawings in the bidding documents, in which the scope of the works is determined;
- the contractor will carefully study these drawings and put issues to the employer for clarification; and
- upon the employer's clarification, the contractor may prepare responses to the bidding documents, including parts related to the scope of the works.

Occasionally, a programme and technical specifications are also used to define and determine the scope of the works in practice, while their major focus is about the standard of quality rather than the scope of the works.

3.2 Variations

Variations by the Employer

The employer generally has the right to vary and often exercises such right via its entrusted supervisor or engineer. With the employer's approval, the supervisor or engineer may issue a notice of variation to the contractor, which may list items to be varied and may (rarely) include a price for such variation. The contractor may then submit a proposal of costs on the variation to the supervisor or engineer within an agreed period upon receiving such notice. Next, the employer will review the contractor's price proposal and may negotiate with the contractor to determine the price for the instructed variation. The usual practice is that parties may refer to the unit price of similar work items as prescribed in the construction contract when determining the price of the variation. If unit prices of similar work items are not stipulated in the contract and the two parties cannot reach an agreement on the price of the variation, the parties may refer to the pricing method or standard issued by the local construction administrative department when the contract is signed.

If the employer requests a design variation, the employer must also ask the engineer designer to provide detailed drawings and explanations of such variation.

Variations by the Contractor

Unlike the employer, the contractor's right to vary is limited. The contractor is not allowed to vary any part of the works unless the employer has approved this. The contractor has, however, the right to submit reasonable proposals to the supervisor or engineer that may accelerate completion, reduce costs or improve the value of the works, etc. The supervisor or engineer will relay such reasonable proposals to the employer for approval. If the employer approves, the super-

visor or engineer will issue a notice of variation accordingly and the same procedure to determine the scope and price of the variation shall apply.

3.3 Design Responsibilities Regarding the Engineering Design

Which parties are responsible for the design process largely depends on which contracting model the parties select.

In a general construction contracting model, the contractor's scope of work only covers construction works that are implemented on the basis of detailed drawings and design documents provided by the employer. The employer will separately engage an engineer designer for design works. As such, the employer bears responsibility regarding the design under the construction contract, while the engineer designer is responsible for its design works under the engineer design contract with the employer. Article 805 of the Civil Code provides that the employer will compensate the engineer designer for actual costs on design work resulting from the employer's change of plan, failure to provide accurate materials or failure to provide the necessary conditions for the design.

In a general project contracting model (engineering, procurement and construction or design-build), the contractor is responsible to the employer for design work under the contract.

3.4 Construction

The contractor takes full responsibility for the construction works, including any subcontracting. If the contractor has subcontracted part of the works to a subcontractor, the subcontractor will be responsible for the subcontracted works. The contractor and subcontractor are jointly

responsible to the employer for the safety and quality of the subcontracted works.

The surveyor and designer shall be responsible for the quality of their survey and design. Survey and design documents shall conform to relevant laws, regulations, construction project quality and safety standards, technical standards for construction project survey and design, and the agreement in the contract. The supervisor shall supervise the quality of construction and bear liabilities for the supervision of such quality under the laws, regulations, relevant technical standards, design documents and the contract.

3.5 Site

The contractor undertakes overall responsibility for the status of the construction site and such responsibility is mandatory under the law. Relevant articles in the Construction Law of the PRC deal with the contractor's responsibility in this respect.

- Article 39 provides that the contractor shall take measures to maintain security, prevent danger and fires and may adopt closed management if conditions permit; the contractor must also take protection measures to prevent the construction site from causing damage to adjoining buildings, structures or the operational environment for special works.
- Article 40 provides that the employer will provide materials for underground piping and wiring and the contractor will take protective measures.
- Article 41 provides that the contractor will comply with laws and administrative regulations relating to environmental protection and safety in production and take measures to control pollution and damages caused by various kinds of dust, leaking gas and water, solid waste as well as noise, vibration, etc.

3.6 Permits

Permits Required for the Construction Process

Normally, to proceed with construction works, the following approvals or permits must be obtained in advance:

- approval/certificate of the right to use the construction land;
- planning approval for the construction land;
- planning approval for the construction project; and
- a construction permit.

Parties Responsible for Obtaining the Permits

The employer is responsible for obtaining all the listed approvals or permits required by mandatory law, thus all the applications are submitted in the name of the employer. In practice, it is often seen in a construction contract that the contractor is required to assist the employer with obtaining such approvals or permits by acting on the employer's behalf and preparing the relevant documents.

3.7 Maintenance

The contractor is responsible for maintenance of the works until all the works and the site are handed over to the employer upon completion. The contractor's maintenance work typically includes looking after the site; inspection and examination of constructed parts; and supervision and repair of utility connections and the power supply. Maintenance works are generally included in the contractor's scope of work in the construction contract. It is rare for parties to enter into a separate contract specifically dealing with maintenance work.

3.8 Other Functions

In a typical construction contracting model, the contractor undertakes only the construction

work, while other works are undertaken by third parties such as surveyors, designers, suppliers, supervisors, etc. The employer may separately engage an operator to manage the business operation of the project.

In complex contracting models incorporating project financing, such as BOT (Build-Operate-Transfer), BOOT (Build-Own-Operate-Transfer), F-EPC (Finance + EPC) and PPP-EPC, the contractor, employer and other third parties, such as financial institutions and project companies, may be involved at different stages and to varying degrees in project financing, transfer and operation.

3.9 Tests

For industrial projects, tests for completion of the works are very common. In a typical construction contract, the contractor may prepare and submit a plan of completion test and the employer, after consulting with the supervisor or engineer, may approve the contractor's plan of completion test. The contractor will then conduct the test according to the approved plan under supervision by the supervisor and/or the employer.

If the works fail to pass the tests, the contractor shall re-test the works after they have been repaired. If the works fail the re-test, the employer will assume the costs for the tests if such failure is on the employer's part. The employer may exercise various remedies if such failure is on the contractor's part, such as requesting the contractor to remedy defects at its own cost, compensate damages caused, exercise rights of set-off, rejection, termination, etc.

3.10 Completion, Takeover and Delivery

A typical completion proceeds as follows.

- Preliminary specialised examinations are conducted by several administrative bureaus such as firefighting, urban planning and lighting protection.
- If the employer considers conditions are ready for acceptance, the employer will convene the surveyor, the designer, the contractor and the supervisor and make a plan for completion acceptance (竣工验收).
- The employer will report to the local authority seven working days before the day of completion acceptance.
- The employer will organise the completion acceptance.
- Should the completed works pass the various tests and checks for completion acceptance, all the attendees will sign a report of acceptance. At this point, the employer will confirm acceptance of the completed works.
- The contractor will hand over all project documents, records and drawings to the employer.
- The employer then files the acceptance report, project documents, records and drawings with the local construction bureau.

These processes influence each other as follows.

The completed works can be delivered for use upon passing completion acceptance; completed works that have not undergone completion acceptance or do not pass completion acceptance shall not be delivered for use.

If the construction project has not been accepted for completion and is delivered for use by the employer, the date of takeover of the completed works shall be the date of completion acceptance.

3.11 Defects and Defects Liability Period Defects Liability Period

There are several Chinese words for “defects liability period”, such as 质量保证期, 缺陷责任期, 质量保修期, which often causes confusion in practice, thus “defects liability period” should be clarified in the relevant terms of the construction contract.

Defects Liability Period Related to Retention Money/Guarantee

Parties are free to agree on a certain time period for the contractor to remedy defects on notice upon completion of the works. There is no mandatory requirement regarding the length of such period by law but an administrative rule suggests that such period is generally one year but shall be no longer than two years. In practice, the defects liability period is often agreed as two years from the date of completion acceptance. Upon expiration of such defects liability period, the employer must return the retention money or release the retention guarantee.

Defects Liability Period Related to Quality of the Project

The contractor has statutory quality warranty obligations within prescribed minimum periods for different parts of the project by law. These cannot be contracted out but can be extended in the contract. On expiration of such quality warranty periods, the contractor is released from contractual and legal obligations to the employer for the quality of the project, but the contractor may still be liable for personal injury or property loss of a third party caused by the project for reasons attributable to the contractor within a reasonable period of its use. Minimum statutory quality warranty periods for different projects are as follows:

- for an infrastructure project, and foundations and main parts of a house building, the qual-

ity warranty period is the number of years of reasonable use as prescribed in design documents;

- for waterproofing works on roofs, toilets, and rooms and outside walls with anti-leakage requirements that should be waterproofed, the quality warranty period is five years;
- for heat supply and air-conditioning systems, the quality warranty period is two heating periods and two air-conditioning periods; and
- for projects involving electric wires, gas, water supply and drainage pipes, equipment installation and decoration, the quality warranty period is two years.

Remedies Available to the Employer

In the event of any defects in the work of the contractor, the employer may request the contractor to remedy such defects at its own cost within a reasonable time period, or it may entrust a third party with the remedial works at the contractor's cost. The contractor shall also be liable for compensating for the losses. If the contractor fails or refuses to remedy defects within the defects liability period or quality warranty period, and further, if such breach is so material that the purpose of the contract cannot be realised, the employer may terminate the contract.

4. Price

4.1 Contract Price

Quota Evaluation and Bill of Quantity

Two pricing methods are generally used to establish the contract price in construction contracts: quota evaluation and bill of quantity.

By using quota evaluation, a party, usually the contractor, applies project quotas and formulations or rules as published by local governments to calculate project costs on labour, materials,

equipment, etc, to establish the contract price. Apparently, this method reflects China's planned economy in the construction sector.

With China's transition from a planned economy to a market economy, the bill of quantity has gradually become more and more popular, replacing quota evaluation in establishing the contract price. The bill of quantity refers to a pricing model where the employer provides a bill of quantity and the contractor proposes prices on different items at its own volition, considering its own costs.

In addition, several other price models are used in contracts; eg, lump-sum price, fixed unit price, costs plus fees, adjusted costs, etc.

Milestone Payments

Payment by milestones is widely used in construction contracts. The payment schedule providing specific milestones is often a major issue in the parties' negotiations and is itself a part of the contract documents. The common arrangement of milestones would include an advance payment, progress payment at different construction stages and return of retention money.

4.2 Indexation

It is common to use indexation of prices to divide the risk of price fluctuations. The contracts between the project owner and the general contractor will often include a formula of price adjustment, stipulating that if the fluctuation exceeds a certain amount, the price will be adjusted accordingly. The index usually used by parties is often the price published by a government market research company, showing the fair market price of a certain material or work. Such market research is regularly conducted by the bureau of construction quality supervision to provide a reference for contractors.

4.3 Payment

Late or Non-payment

The employer's primary obligation in the construction contract is to pay on time as agreed. As such, late payment or non-payment is the employer's breach. Almost all construction contracts include relevant terms dealing with late payment or non-payment, such as liquidated damages (eg, a daily rate for late payment), and the contractor's right to suspend or terminate.

Depending on the circumstances, the contractor may claim payable amounts together with liquidated damages for late payment. If the contract is silent on liquidated damages, the contractor can also claim loss of interest, calculated based on contemporaneous and homogeneous loan interest rates or the contemporaneous loan prime rate under Article 26 of Interpretation of the Supreme People's Court on Issues Concerning the Application of the Law in the Trial of Construction Project Contract Dispute Cases (I). If the employer's late payment or non-payment constitutes material breach, the contractor may suspend works or even terminate the contract on condition that the contractor reasonably urges the employer to rectify such breach in advance.

Advance Payments, Delayed Payments and/or Interim Payments

It is common for a traditional construction contract to include an advance payment and interim payment in the employer's payment schedule. However, if an advance payment refers to the contractor's advance payment (ie, the contractor contracts works with its own funds), this would be deemed as the employer's outstanding payment to the contractor. Furthermore, if the contract is silent on the matter of interest on the contractor's advance payment, the court may not support the contractor's claim of interest loss on such advance payment.

Delayed payment is often regarded in the same light as late payment, as illustrated above in a traditional construction contract. Yet in some creative models of project contracting, delayed payment may be used as a financing tool.

In government investment projects, the parties are not allowed to use the contractor's advance payment in construction practice or use delayed payment as a project financing tool.

4.4 Invoicing

Invoicing is highly regulated in various areas in China and the construction sector is no exception. Invoices are issued on standard forms and printed out through a special tax-control printing machine that connects to the supervision system of local tax bureaus. By this means, the tax authority supervises the authenticity of the invoice and inspects the tax payment status of each individual invoice.

The service provider or the seller are often the party to issue invoices. In the construction sector, the issuing party is often the contractor. The issuing party is not allowed to delegate the issuing of invoices on its behalf to a third party.

It is common in construction contracts that parties include invoices as one of the payment conditions; ie, the contractor must issue an invoice against amounts payable and the employer must pay within a certain number of days upon receipt of such invoice, as agreed.

5. Time

5.1 Planning and Programme

The planning of the construction is done by the contractor and is incorporated into the construction contracts as part of the contractual docu-

ments. If the construction contract is concluded via a bidding and tendering process, the planning would be proposed and included in the contractor's bid documents in response to the employer's substantive requirements. If the construction contract is concluded via direct negotiation, the planning done and proposed by the contractor would be a key issue for the parties to negotiate.

The employer may review the planning proposed by the contractor and check whether it is feasible and in line with the overall project plan. Upon the employer's approval, the parties may include the planning as part of the contract documents. If the planning does not meet the contract requirements or is inconsistent with the actual progress of the project, the employer may directly notify the contractor to revise the planning; if the contractor needs to make changes to the planning, the contractor shall report to the employer for approval in advance.

To safeguard the planning, the contractor will also make the construction organisation and implementation plan, record the actual progress and make the monthly progress report, then put forward the situations that may cause delay and the solutions.

Milestones

It is very common to have milestones in the planning, which often correspond to progress payments; ie, milestone payments. Some construction contracts may include liquidated damages should the contractor fail to meet milestones as set in the planning. For industrial projects, an interim certificate may be used to mark completion of a major milestone.

5.2 Delays

If a delay occurs, the first thing the parties need to do is identify the cause of the delay.

- If it is on the employer's part, the contractor may claim extension of time and reasonable costs as provided in the contract.
- If it is on the contractor's part, the contractor will not have the right to claim extension of time or any costs. On the contrary, the contractor may need to pay liquidated damages, compensation for losses on delay to the employer and take further measures to accelerate the works to meet the completion date at its own cost.
- If the delay is caused by a force majeure, the contractor shall notify the employer immediately of the occurrence of the force majeure, with proof, and take measures to mitigate the effects. The completion time will be extended accordingly.

5.3 Remedies in the Event of Delays

Many construction contracts include liquidated damages for delay. In the event of delay on the part of the contractor, the employer may be entitled to claim such liquidated damages, compensation for losses and may request the contractor to accelerate the works at its own costs. If the critical path of the progress is seriously delayed on the contractor's part, the employer may exercise its right to terminate the contract.

Likewise, in the event of delay on the part of the employer, the contractor may claim for extension of time and actual losses related to time. A serious suspension caused by the employer may trigger the contractor's exercise of its right to terminate.

5.4 Extension of Time

Typically, the contractor will submit a notice of delay to the supervisor or engineer, as entrusted by the employer, within a certain period as agreed in the contract. The contractor will usually send this notice together with evidence to prove the

occurrence and cause of the delay and its impact on the works. The contractor may also send a claim letter on extension of time and costs shortly after or simultaneously with the notice on delay. The notice sent by the contractor, together with the reply of the supervisor or engineer, establish evidence of the extension of time. Additionally, the report or daily record of the supervisor is common evidence of the extension of time.

5.5 Force Majeure

The term “force majeure” is defined in Article 180 of the Civil Code. It is “an objective event which is unforeseeable, unavoidable and insurmountable by the parties”. In a traditional construction contract, parties may repeat the legal definition of “force majeure” and provide some specific circumstances as instances – eg, earthquake, tsunami, plague, rebellion, war, insurrection, riot, etc.

The parties are generally free to agree in the contract a broader scope of application and relief for similar events, which will generally be given effect. However, in that case, contractual provisions will apply, as supplemented by the force majeure provisions under the law, to the extent relevant to those events that meet the legal definition of “force majeure”. In contrast, in China’s current jurisdiction, courts and arbitration institutions tend to believe that “force majeure” is a natural phenomenon that cannot be avoided by human forces, meaning it is a legal exemption and cannot be exempted due to the exceptions of the parties. Those events being limited or excluded that do not meet the requirement of “force majeure” under the law will be afforded relief and/or entitlement only as agreed between the parties to share the loss of the consequences after the occurrence of the force majeure event.

5.6 Unforeseen Circumstances

Principle of “Change of Circumstances”

Risks such as unforeseen ground conditions, a change in the law, fluctuations in the price of materials and labour, etc, frequently occur in construction practice, which may trigger application of the principle of “change of circumstances” at law.

The principle of “change of circumstances” was first introduced in the Interpretation on Certain Issues Concerning the Application of the Contract Law (II) and is now codified in the Civil Code.

Article 533 of the Civil Code provides that “where the basic conditions of a contract undergo a material change unforeseeable by the parties at the time of contracting which is not a commercial risk after the formation of the contract, rendering the continuation of the performance of the contract unconscionable for either party, the adversely affected party may renegotiate with the other party; and if the renegotiation fails within a reasonable time limit, the party may request the people’s court or an arbitration institution to modify or rescind the contract”.

As a result, in the event of unforeseen circumstances that may substantially change basic conditions at the stage of contract conclusion, one party may propose to renegotiate the contract terms with the counterparty. Should the renegotiation fail, either party may apply for the court or the arbitral tribunal to step in to revise the relevant terms or to terminate the contract on the basis of the principle of fairness.

5.7 Disruption

There is not any clear definition in China’s legislation or sample contract regarding disruption. There is no systematic study or inspection that can establish or measure the market disturbance

which leads to disruption or other legal effect, although from the practitioner's view the disruption exists, to some extent in some sub-industry.

Therefore, disruption is not yet acknowledged as a legal element or situation which causes extension or compensation. However, other methods of dealing with the adverse effect can be seen, such as reference to the force majeure or "change of circumstances" principle. A recent example in 2017–2018 occurred when the concrete industry was substantially affected by the environmental protection campaign of the central government, and many contracts referred to the "change of circumstances" principle to find a fair solution rather than introduce the concept of disruption.

6. Liability

6.1 Exclusion of Liability

General Clauses

Article 506 of the Civil Code provides: "the following exclusion clauses in a contract shall be void: (1) those that cause personal injury to the other party; (2) those that cause property damages to the other party as a result of wilful misconduct or gross negligence".

It is therefore not possible to exclude liability for personal injury or death to the contractual counterparty and liability for property damages to the contractual counterparty as a result of wilful misconduct or gross negligence.

Standard Clauses

Under Articles 496 and 497 of the Civil Code, clauses that are "standard" – ie, clauses that one party uses repeatedly in its contracts and which, in the case of the particular contract in question, are included and not negotiated with the other party, would be deemed void where

they attempt to exempt the liability of the party who includes them; or where they unreasonably decrease the liabilities of the party that includes them, increase the liabilities of the other party or limit the rights of the other party.

Besides the legal position for a general contract above, parties to contracts in a specific industry may not contract out of mandatory liabilities prescribed at law. For instance, the contractor must assume statutory quality warranty obligations within the prescribed minimum periods for different parts of a project, which cannot be contracted out in the construction contract.

6.2 Wilful Misconduct and Gross Negligence

The concepts of "wilful misconduct" and "gross negligence" are not expressly defined at law.

However, in practice, the courts have discretion to apply these concepts to cases by considering specific circumstances and the failing party's expertise. Generally, "wilful misconduct" illustrates a person's intention where they can reasonably foresee another's losses owing to their action/breach but they still wish or allow it to happen.

"Gross negligence" refers to a person's intention where they are in serious breach of the duty of care and should have foreseen, but fail to foresee, or have foreseen but measures haven't been taken due to credulity, the losses caused to another by their action/breach. In a Supreme People's Court (SPC) judgment ((2016) Zui Gao Fa Min Shen 381), the SPC found that DHL Shangdong Company (DHL) failed to deliver a package in accordance with the agreed post-operation procedures and held that DHL's breach did not reach the threshold of "wilful mis-

conduct” but should be ascertained as “gross negligence”.

6.3 Limitation of Liability

Limits/Caps on Liability

Articles 496, 497 and 506 of the Civil Code and their restrictions on exclusions of certain types of liability only apply to absolute exclusions. Generally, limitations of liability are permissible; however, all such limitations are subject to the principles of fairness and good faith, which are also codified in Articles 6 and 7 of the Civil Code. The courts could potentially use these principles to hold that limitations of liability are unfair or in breach of the principle of good faith, and they have the power to step in and adjust such limits. This is well-reflected in the application of liquidated damages.

Liquidated Damages

Parties are allowed to limit liabilities for their breach by including terms of liquidated damages. However, the court may adjust the liquidated damages on a party's application if:

- the liquidated damages are significantly higher than the actual losses suffered by the complying party – ie, the liquidated damages are more than 30% higher than the actual losses suffered; or
- the liquidated damages are lower than the actual losses suffered.

In fact, besides the gap in the amount between liquidated damages and actual losses, the court will also look into other factors, such as the parties' performance under the contract concerned, the extent of culpability of the relevant party in causing the losses suffered, etc.

7. Risk, Insurance and Securities

7.1 Indemnities

As model construction contracts do not adopt indemnity terms in the FIDIC forms, parties using model forms rarely include indemnity terms in the contract. However, if parties elect to use the FIDIC forms for projects involving foreign elements, indemnity provisions relating to personal injury and damage to property (other than the works) during the course of the project will be included in the FIDIC forms.

Some provisions equivalent to indemnities exist in the Model Contract for General Contracting Projects – ie, provisions that one party shall be responsible to the other party for contractual breach resulting from a third party's fault, and that one party shall be responsible for any claims on intellectual rights by a third party.

7.2 Guarantees

There are no restrictions on the nature and types of guarantees. Bonds, usually on-demand bonds (creating a primary obligation on the bondsman to pay), issued by banks or financial institutions, are commonly used in practice. Occasionally, parent companies may provide guarantees for the performance of subsidiary companies.

Various guarantees are involved in the process of project construction, such as advance payment guarantee, performance guarantee, retention money guarantee, payment guarantee, etc.

- An advance payment guarantee is provided by the contractor in an amount equal to the advance payment.
- A performance guarantee is provided by the contractor to secure its due performance under the construction contract. A performance guarantee is not mandatory. The

employer and the contractor shall agree on the method, amount and submission time in the contract. The performance guarantee can be in the form of bank guarantee or guaranteed by a bonding company.

- A retention money guarantee is an alternative to the employer's retention money. The Ministry of Finance and MOHURD have jointly issued an administrative measure on managing the practice of retention money, which provides that a retention money guarantee shall not exceed 3% of the final settlement of the project's total price, though the provisions of this administrative measure are not mandatory.
- A payment guarantee is provided by the employer to secure its payment obligation to the contractor, but is rarely used in practice.

7.3 Insurance

For construction projects, the most common types of insurance are construction/erection all-risk insurance and third-party liability insurance, which can be taken out by the contractor or the employer, or both, depending on the parties' agreement. Construction/erection all-risk insurance provides coverage for property damage; and third-party liability insurance provides coverage for injury, illness or loss to property of third parties or damage claims, and is not mandatory.

Both the employer and the contractor have a mandatory legal obligation, however, to take out work injury insurance for their respective employees. The contractor is further mandatorily required to procure accident liability insurance for employees who engage in dangerous operations.

7.4 Insolvency

Taking the Model Contract for General Contracting Projects as an example, one party's insolvency

may trigger circumstances where the other party has the right to terminate the contract by immediate notice without giving advance notice of its intention to terminate.

7.5 Risk Sharing

Risk Allocation Between Parties

Many terms in a construction contract are designed to allocate responsibilities between the parties in respect of certain risks.

Under Measures for the Administration of General Contracting of House Building and Municipal Infrastructure Projects, major risks allocated to the employer include:

- fluctuation exceeds the range agreed by the parties in the price of materials, equipment and labour compared with the price at base date;
- fluctuation in the price due to a change in the law;
- unforeseen ground conditions;
- delays and additional costs on the part of the employer; and
- delays and additional costs for force majeure.

This does not provide a mandatory mechanism for allocating risks, but a reasonable mechanism for parties' reference. Parties may allocate risks considering their specific projects and circumstances but are generally expected to allocate risk in a reasonable manner.

Most shared risks are not actually "shared" but are allocated between the parties. This means that the parties do not proportionally distribute or price a particular risk; instead, the entire burden of the risk is placed on one party. To achieve balance, the parties strive for a comparatively equal allocation of risks.

Risk Sharing Between Parties

Risk sharing depends on the mechanism of risk allocation between the parties. Taking the Model Contract for General Contracting Projects as an example, both parties may share certain risks as follows:

- abnormal weather conditions – the contractor shall take reasonable measures to proceed with the works and the employer shall grant an extension of time accordingly; and
- force majeure:
 - (a) the employer bears the cost of damages to permanent works, and the cost of personal injuries and property loss of third parties resulting from such damages;
 - (b) the contractor bears the cost of damages to the contractor's equipment;
 - (c) each party bears its own personal injury and other property damages;
 - (d) additional costs for the suspension of the works shall be reasonably allocated between both parties; and
 - (e) acceleration costs per the employer's instruction, and the contractor's additional costs for caring for and cleaning the site, and remedying the project, shall all be for the employer's account.

8. Contract Administration and Claims

8.1 Personnel

The Employer's Personnel

In general, the employer's personnel include the employer's representative and other personnel sent to the site by the employer. The employer's representative may act on behalf of the employer within the scope of authorisation. Details and the scope of authorisation of the employer's representative shall be expressly included in the con-

tract. Should the employer replace its appointed representative, the employer shall notify the contractor in writing within a certain number of days before such change.

The Contractor's Personnel

The contractor's personnel include the project manager and all other personnel sent to the site by the contractor. The contractor is required to submit a report about its project manager, technical manager, construction manager and all personnel on site to the supervisor within a certain number of days after receiving the notice of commencement. In addition, the contractor must provide an employment contract, plus proof of payment of social insurance for its major managing staff on project.

In particular, the contractor's project manager must have a corresponding civil engineering qualification. The project manager in a general contracting project is not allowed to act for two projects in the role of project manager or construction manager at the same time. Furthermore, the project manager shall assume lifelong liability for the quality of the project.

The Supervisor

The employer may entrust a supervisor (very often a supervising institution or company other than a natural person) to check and examine the works, review project documents and issue notices on the employer's behalf within the scope of authorisation. The supervisor may send a supervising director and a supervising engineer to site to act accordingly.

8.2 Subcontracting

It is very common for the contractor to subcontract part of its works to subcontractors. There are two types of subcontractors: the speciality subcontractor and the labour subcontractor.

The contractor must comply with certain legal requirements on subcontracting so that the subcontracting is legal and will not be deemed as void under the law:

- unless the construction contract provides otherwise, the contractor must obtain the employer's consent before subcontracting;
- the contractor may not subcontract the entirety of its works to a subcontractor;
- the contractor may not subcontract part of its works to an unqualified subcontractor or an individual;
- the contractor may not subcontract its works for the main structure, save for steel structure work;
- a speciality subcontractor may not further subcontract speciality works (subcontracted by the contractor) to another subcontractor, save for the labour works of the subcontracted speciality works; and
- a subcontractor may not further subcontract labour works (subcontracted by the contractor) to another subcontractor.

8.3 Intellectual Property

In general, the intellectual property right belongs to the author of the work. Such work in a typical construction process may be in the form of drawings, working records, technical documents, technique development, communications in texts, etc. The construction work itself does not constitute a work within the concept of intellectual property.

Parties to the construction contract may include relevant provisions dealing with intellectual property rights. These provisions, in general, would be:

- for drawings and technical documents provided by the employer, all the intellectual

property rights belong to the employer and the contractor may only copy and use these documents for the purpose of carrying out the works;

- for documents the contractor makes for the purpose of carrying out the works, the contractor only has the right of authorship and all other intellectual rights belong to the employer, and likewise the contractor may not use these documents for purposes unrelated to the construction works; and
- each party shall be responsible for its own wrongful use of a third party's intellectual property rights.

9. Remedies and Damages

9.1 Remedies

Construction contracts generally include various remedies that each party can exercise in the event of failure by the other party to comply with an obligation. Financial remedies, as well as some courses of action, are available to the parties; to name a few:

- damages such as liquidated delay damages for the employer and liquidated payment delay damages for the contractor;
- compensation of any expenses and losses caused to the other party due to violation of law or the contract;
- suspension, as in the employer may prevent progress of unsafe work;
- termination by either party under material breach by the other party;
- the employer's withholding of payment; and
- the employer's notice to remedy defects.

9.2 Restricting Remedies

Financial remedies in the form of liquidated damages are usually available to the parties.

Liquidated damages are designed to reflect the complying party's loss caused by the failing party's breach, which could have been reasonably foreseen by the failing party at the time of concluding the contract. Should such liquidated damages be significantly higher or lower than the complying party's actual loss, the court may step in to adjust such liquidated damages, applying principles of fairness. See **6.3 Limitation of Liability** for more details on this point. In model contracts, except for losses caused by fraud, crime, intent, gross negligence, personal injury and other misconduct, both parties' agreement on the restriction of remedies also includes that the contractor's compensation to the employer shall not exceed the agreed maximum amount or the contract price.

9.3 Sole Remedy Clauses

It is rare to see a sole remedy clause in a construction contract. Should a sole remedy clause be included, it is highly likely to be a limit on liability with a cap figure. Such clause is generally valid and enforceable subject to legal requirements on exclusion and limitation of liability clauses, which are discussed in **6. Liability**.

9.4 Excluded Damages

See **6.1 Exclusion of Liability**.

9.5 Retention and Suspension Rights

Retention Rights

If "retention rights" refers to the contractor's right to retain works in the event of the employer's failure to pay, the contractor does not have such a right under the law, but the contractor may claim priority right to compensation.

If "retention rights" refers to the employer's right to withhold a certain amount of money as retention money against the contractor's obligation to remedy defects within the defects notifica-

tion period, this is a very common right for the employer. As the employer has greater negotiation power than the contractor, it is almost impossible in practice to contractually exclude the employer's retention rights.

Suspension Rights

In terms of suspension rights, suspension is a common remedy, or at least a protective threat, invoked by the contractor in the event of late or non-payment by the employer or other breach of contract that makes the contractor unable to continue to perform the contract. In a construction contract where suspension rights are excluded, this often means that the contractor has no right to suspend works but has a right to claim compensation as an alternative. There have been quite a few successful claims by contractors relying on such clause, which indicates that this contractual arrangement is held valid by the courts and tribunals.

9.6 Termination

Termination of a contract is usually triggered by a serious breach of contract, and sometimes only those breaches which lead to frustration of contract may entitle a party to terminate. For example, if the critical path of the progress is seriously delayed on the contractor's part, the employer may exercise its right to terminate the contract.

It is stipulated by Article 565 of the Civil Code that a notice shall be issued to terminate the contract. However, the party may seek such termination right directly at a court by filing a case.

According to the Civil Code, the result of termination of a contract includes:

- immediately stopping and cancelling the performance of the contract; or

- settling, paying or returning the performed part of the contract.

The termination does not affect the responsibility arising from the previous performance or violation of the contract.

In a more specific situation, termination of a construction contract often leads to the settlement of the already completed part and forces the parties to discern the proportional responsibility of such termination or previous violation of the contract.

10. Dispute Resolution

10.1 Regular Dispute Resolution

In terms of or in a construction-related case, the court of the place where the project is located has exclusive jurisdiction to adjudicate the case. The level of the first instance court is determined based on the threshold of claims and the complexity of the case.

Court System

Generally, the court system is divided into four levels:

- basic courts at district level;
- intermediate courts at city level or equivalent;
- high courts at provincial or direct-controlled municipality level; and
- the SPC.

Thresholds for Allocating Jurisdiction

There are different thresholds for allocating jurisdiction between the four levels of court. For instance, in a domestic case where both parties reside in Beijing, if claims are over CNY100 million, the first instance of the case will be heard before the intermediate courts in Beijing. As

most project claims are high in value, the first instance case will usually be adjudicated before an intermediate court.

10.2 Alternative Dispute Resolution Arbitration

In practice, as construction cases involve technical elements, the parties are commonly willing to enter into a written arbitration agreement to resolve disputes before an arbitration institution, such as the Beijing Arbitration Committee and the China International Economic and Trade Arbitration Commission.

Mediation

Mediation also plays an important role in resolving construction disputes, sometimes as an independent process and sometimes as part of the arbitration/litigation process. For the widely known “arbitration-mediation” mechanism, the arbitrator may play two roles in the process.

Dispute Review Boards

Several arbitration institutions provide a construction project dispute review service and have a panel of experts with legal and technical expertise. This review procedure borrows wisdom from the Dispute Adjudication Board (DAB) and the Dispute Review Board (DRB) in the FIDIC forms. Whether the experts’ review decision has a binding effect is subject to the parties’ agreement in the construction contract. Should the construction contract be silent on this, the review decision shall be binding on the parties according to the review procedure rules.

Trends and Developments

Contributed by:

Hong Lu, Ping Zhang, Xiaoxia Zhang and Ping Xiang

Merits & Tree Law Offices

Merits & Tree Law Offices has a real estate and infrastructure team led by four key partners and more than ten supporting partners, in addition to over 20 lawyers. The team provides contentious and non-contentious legal services in the sector, including construction and engineering of buildings and infrastructure, real estate development and sales, land acquisition, project mergers and acquisitions, urban renewal, property management and operation, project invest-

ment and financing, project tax planning and asset-backed securitisation. The lawyers advise local giant real estate developers as well as various construction companies in China, such as Vanke, Longfor and Greentown. The team provides strategic and professional solutions to clients on contract negotiation, bidding and tendering, construction claims and disputes, and on-demand guarantee-related matters.

Authors



Hong Lu is a partner at Merits & Tree Law Offices. His practice and experience focus on legal services in real estate and infrastructure. He is an expert in dispute resolution regarding risk

control, and in connection with construction projects, including strategy making, business negotiation, identification of potential risks and provision of resolutions. Mr Lu was one of those who drafted the Operating Guidelines for Lawyers Handling Construction Project Cases issued by the All China Lawyers' Association, and has been awarded as the Highly Recommended Lawyer of the Engineering Industry by ENR/Construction Times multiple times. Mr Lu also serves as arbitrator at several arbitration institutions.



Ping Zhang is a partner at Merits & Tree Law Offices. Her practice focuses on construction and infrastructure, real estate transactions and complex commercial dispute resolution.

In the past 30 years, Ms Zhang has gained extensive experience in providing legal services for SOEs, leading real estate enterprises, government departments, urban investment companies, and financial bureaus in construction, real estate development and commercial property operation, bulk property transactions, M&A, PPP and concession, land replacement, government bonds and urban renewal projects. She is currently the deputy director of Hubei Lawyers Association Construction Real Estate Law Professional Committee, arbitrator of Wuhan Arbitration Commission, Jingmen Arbitration Commission and Shijiazhuang Arbitration Commission.

CHINA TRENDS AND DEVELOPMENTS

Contributed by: Hong Lu, Ping Zhang, Xiaoxia Zhang and Ping Xiang, **Merits & Tree Law Offices**



Xiaoxia Zhang is a partner at Merits & Tree Law Offices. She focuses on legal services and research in the field of real estate and infrastructure and has been involved in a number of infrastructure and commercial real estate projects, including development and financing, construction and dispute resolution, housing, municipal, petrochemical, civil aviation, new energy and so on. In addition, she has served as an arbitrator and an adjudicator at many well-known arbitration institutions in Beijing, Shanghai, Shenzhen, Guangzhou and other places, and has rich experience in arbitration cases related to real estate and construction projects.



Ping Xiang is a partner at Merits & Tree Law Offices and is dedicated to providing legal services in the field of real estate and infrastructure, including full process non-litigation consulting and dispute resolution legal services for real estate investment, construction, and operation management. Mr Xiang has provided specialised consulting services and litigation/arbitration agency services throughout the investment, construction, and operation process for multiple commercial residential development projects, bank headquarters building projects, pharmaceutical research and development bases, port terminal expansion projects, industrial park renewal projects, local financial centre landmark projects, and highway projects.

Merits & Tree Law Offices

Unit 1801
Raffles City Changning Office Tower 1
No 1133 Changning Road
Changning District
Shanghai 200051
People's Republic of China

Tel: +86 21 5253 3500
Fax: +86 21 5253 3599
Email: Zheyuan.jin@meritsandtree.com
Web: www.meritsandtree.com



Overview

When government policy guidance, environmental protection and green building, and technological innovation jointly affect the Chinese construction business, the market presents multi-level development trends. First, the Chinese government may promote a more stable and balanced development of the real estate market through increased support for infrastructure construction, promoting new urbanisation development, and controlling fluctuations of the property price. These policies will directly affect the demand and development of the construction market. Second, as people's attention to environmental protection and sustainable development grows, green buildings will become the future trend. The government may enact related policies to encourage and support the development of green buildings, thereby bringing new growth opportunities to the construction industry. Third, technological innovation will also become an important driving force for the development of the construction industry. For example, the application of BIM technology and smart building technology will become important directions for the future construction market, bringing more efficient and smarter solutions to the construction industry.

Reform in the Construction Engineering Inspection Industry

On 29 December 2022, the Ministry of Housing and Urban-Rural Development (MOHURD) of the People's Republic of China issued Order No 57, announcing the reformed "Measures for the Management of Construction Engineering Quality Inspection", which came into effect on 1 March 2023.

Construction engineering quality inspection, referring to those inspections on the material quality or the project quality, is often conducted

by a certified institute or laboratory entrusted by the project owner or the government, and the inspection reports are required to be attached to the project files. It is a crucial aspect of controlling project quality, serving as a key means of government engineering quality supervision and an important basis for evaluating project quality. In 2005, the former Ministry of Construction issued the "Measures for the Management of Construction Engineering Quality Inspection" (Ministry of Construction Order No 141), which regulated the qualification licensing, business operations, and supervision of inspection activities of construction engineering quality inspection institutions, playing an important role in standardising inspection behaviours, maintaining the order of the inspection market, and ensuring the safety of project quality. However, with the continuous development of the construction market and inspection industry, and the increasing demands of the people for building quality, the content of Order No 141 can no longer fully meet the needs of industry development and regulation.

The amended regulation has expanded the types of entities in the testing market and strictly standardised the testing behaviours. More specifically as follows.

- Enterprises, institutions, and partnerships with or without independent legal personality are allowed to apply for the qualification of testing institutions, enriching the types of market entities.
- The process of testing, including commissioning, sampling, labelling, submission for testing, and sample acceptance, has been standardised. Testing institutions are required to establish and use an information management system to ensure the authenticity and accuracy of testing data.

- Testing institutions are required to continuously improve their technical capabilities, strengthen personnel training, and regularly calibrate instruments and equipment to meet the requirements of engineering quality testing.
- The responsibility system for construction project quality testing has been improved, clarifying the responsibilities and obligations of relevant units and individuals, and specifying related prohibited behaviours.
- Specifications have been established for the reporting of testing results and data retention mechanisms.

Reform in the Qualification System of Contractors

On 6 March 2023, the MOHURD issued a notice titled “Notice on Further Strengthening the Management of Qualification Approval for Construction Enterprises”, which deploys measures to enhance the efficiency of qualification approval, unify national qualification approval authority, strengthen the assessment of enterprise restructuring, improve performance evaluation methods, and intensify dynamic qualification checks for construction enterprises. This notice is following the Ministry’s 2021 pilot projects in 15 regions to delegate the authority for qualification approval of construction enterprises, transferring part of the qualification approval to the provincial housing and urban-rural development authorities in the pilot regions.

The notice outlines the following key measures.

- Enhancing the efficiency of qualification approval – authorities should improve the qualification approval mechanism and ensure timely decision-making within two months for qualifications under the Ministry’s responsibility.

- Unifying national qualification approval authority – the Ministry will uniformly handle qualification approvals. Pending applications in pilot regions should be processed within the specified time. Qualifications issued during the pilot period will remain valid until expiration, and matters such as suspension of business, lowering qualification levels, revoking, or cancelling qualification certificates for enterprises will be implemented by the housing and urban-rural development authorities in the pilot regions.
- Strengthening assessment of enterprise restructuring – assessment of original and successor enterprises for qualification approval due to restructuring must comply with qualification standards. Assessment for qualification approval due to merger should evaluate enterprise assets, personnel, and relevant legal relationships.
- Improving performance evaluation methods – enterprises applying for qualifications under the Ministry’s jurisdiction must have projects graded A on the National Construction Market Supervision Public Service Platform.
- Intensifying dynamic qualification checks – authorities should improve information tools to conduct dynamic checks on registered personnel and promptly disclose verification information. Enterprises failing to meet qualification standards will be marked as abnormal on the National Construction Market Platform, with a deadline for rectification.

These measures aim to streamline and standardise the qualification approval process, ensuring the credibility and efficiency of construction enterprises in the industry.

The Digital Management of the Entire Lifecycle of Construction Projects

On 24 October 2023, the MOHURD issued a notice, deciding to launch pilot reforms for the digital management of the entire lifecycle of construction projects.

The decision to implement digital management reform pilot projects may have been based on an understanding and analysis of the current state of management in the construction industry, including possible issues such as information asymmetry, low management efficiency, and inadequate supervision.

The notice requires the local government and contractors to do the following.

- In every department or region, use a standardised electronic platform with uniform application forms and materials for engineering construction project approval matters and build a standard sample database. Strengthen the application of electronic documents, electronic signatures, etc, focus on promoting paperless reporting, and achieve comprehensive electronic certification of approval results.
- Establish coding and mapping mechanisms for individual buildings, by establishing work procedures and operational guidelines for the division, coding, and mapping of individual buildings, according to the “Unified Coding and Basic Attribute Data Standards for Building Construction”. In addition, the local government should assign a unique code to each building entity for the entire lifecycle, and associate it with the project code.
- Establish a mechanism for collecting and sharing data throughout the lifecycle. The local government should promote the inter-connection and collaborative application of

related systems such as project approval, construction market supervision, real-name management of construction workers, quality and safety supervision, and housing safety management.

The MOHURD intends to make information at various stages of construction projects more accurate, timely, and shared, thus enhancing the efficiency and transparency of project management, as well as to reduce errors and delays in management processes and to promote the intelligent and informed transformation of the construction industry.

A National Survey of Natural Disaster Risks

The comprehensive national survey on natural disaster risks, initiated since 2020, was successfully completed by the end of 2023, with the participation of various departments, mainly including the Ministry of Housing and Urban-Rural Development, the Ministry of Transport, and the State Forestry and Grassland Administration.

The completion of this nationwide survey marks an important step forward for China in the field of natural disaster prevention and mitigation. By comprehensively understanding the situation of housing construction and municipal facilities, the government and relevant departments can more effectively formulate disaster response and prevention measures, thereby enhancing society’s resilience against disasters.

In addition, a large amount of data has been generated, especially data reflecting the spatial location and physical attributes of building structures, providing important references for urban and rural planning, land use, architectural design, and other decision-making aspects. The digitised management of this data also lays the

foundation for future smart city construction and urban planning.

The issuance of a “digital identity card” for building structures will also help strengthen supervision over building safety and quality, thereby improving the safety and sustainability of buildings. Overall, this survey is of great significance for enhancing China’s disaster prevention and response capabilities and promoting urban development and construction.

At the same time, the survey achieved full coverage in the highway and waterway industries, forming a set of natural disaster risk zoning maps for the transportation industry and establishing a database for natural disasters in the transportation industry, comprehensively mastering data information on highway and waterway facilities attributes as well as natural disaster risk information.

Creation of “Super Priority Right” by the Supreme Court

Construction priority refers to the priority right enjoyed by the contractors, under specific circumstances, over the land or property involved in their ongoing construction project. This priority right even takes precedence over debts secured by mortgages. However, in April 2023, the Supreme People’s Court issued an official reply regarding consumer rights protection issues related to disputes arising from real estate developers’ failure to deliver purchased properties on time, titled “Reply on Issues Concerning Consumer Rights Protection in the Purchase of Commercial Housing”. The reply provides clear guidelines.

- If a consumer purchases a property for residential purposes and has already paid the full purchase price, asserting their right to

demand property delivery takes precedence over the construction priority right, mortgage rights, and other debts, the court should support this claim.

- In cases where the property cannot be delivered and there is no possibility of actual delivery, if consumers claim the right to refund, the purchase price takes precedence over the construction payment priority right, mortgage rights, and other debts, and the court should support this claim.

These rights enjoyed by the consumer are now often referred to as “super priority rights” and will enhance the legal protection level for consumers when purchasing properties, boost buyer confidence, and promote the healthy development of the real estate market, especially given the context of “protecting livelihoods and ensuring property delivery” policy.

Supreme Court’s Further Clarification of the “Construction Priority Right”

In the third issue of 2023, the Supreme Court Gazette published a construction contract dispute case between Sichuan Zhongmei and a real estate company in Chengdu, confirming that pit support, dewatering, and earthwork engineering still fall within the scope of priority right for construction projects.

The cases published in the Gazette by the Supreme People’s Court, and provincial-level people’s courts are “for reference only” and do not have mandatory legal force, but they have a strong guiding role in the trial work of various levels of people’s courts.

To summarise the Supreme Court’s opinion: The building materials and labour invested by the pit engineering contractor in the construction project have been materialised into the build-

ing and are inseparable from the building itself. Therefore, the contractor of the pit construction contract should enjoy priority rights to be compensated for this part.

The ruling of this case is of great significance for clarifying the scope of priority for construction projects. Pit support, dewatering, and earthwork engineering are usually considered important links in construction projects, directly related to the safety and stability of buildings. Therefore, including these projects in the scope of priority for construction projects helps ensure the smooth progress of construction projects, guarantees the quality of engineering, and provides a clearer basis for construction parties to enjoy priority rights to be compensated during the construction process.

The Debate to Include Rural Housing into the Jurisdiction of Construction Law

On 29 April 2022, the collapse of an old rural building occurred suddenly in Changsha, Hunan Province, causing a casualty of 54 souls. In May 2023, the State Council's executive meeting reviewed and approved the investigation report on the collapse, causing a nation-wide debate.

The collapse incident in Hunan may be seen as a triggering event that has drawn attention to and scrutiny of rural self-built houses. Against this backdrop, the MOHURD is considering incorporating rural self-built houses into the scope of the Construction Laws, which signifies that the government will strengthen the regulation and management of rural self-built houses.

There are a series of problems with rural self-built houses, including substandard construction quality, multiple safety hazards, and lack of supervision. However, rural self-built houses are not directly regulated by Construction Laws.

Traditionally, rural self-built houses are often designed and constructed by farmers themselves, with less government oversight.

Therefore, incorporating rural self-built houses into the scope of building law adjustments will help regulate rural construction activities, improve the quality and safety level of rural buildings, and strengthen the supervision and management of rural self-built houses, thereby reducing the occurrence of similar accidents. This measure is of positive significance for ensuring the safety of farmers, promoting rural construction, and rural revitalisation.

The Establishment of Court-To-Court Mediation Co-ordination Mechanism

The joint establishment of the "court-to-court" online litigation and mediation co-ordination mechanism in the housing and construction field by the Supreme Court and the MOHURD is an important initiative. Specifically, the core of this mechanism is to integrate the resources of the Supreme Court and the MOHURD through an online platform, providing convenient litigation services and dispute resolution channels for parties involved, thus more effectively addressing civil disputes in the housing and construction sector.

This online litigation and mediation co-ordination mechanism typically includes the following aspects.

- Online litigation services – parties can initiate litigation through the online platform and go through procedures such as case filing and evidence submission, facilitating a streamlined litigation process.
- Dispute resolution channels – the online platform provides dispute mediation services,

including online mediators assisting parties in mediation to resolve disputes.

- Resource integration – the Supreme Court and the MOHURD integrate various resources, including legal experts and mediators, to provide comprehensive legal support and services to parties involved.

This “court-to-court” co-ordination mechanism is expected to enhance judicial efficiency, reduce litigation costs, and promote social stability and the rule of law. Through the application of online platforms, dispute resolution becomes more convenient and efficient, which is conducive to promoting legal protection and standardised development in the housing and construction field.

COLOMBIA

Law and Practice

Contributed by:

Julián Felipe Rojas Rodríguez, David Garzón Gómez,
Ángela María Caicedo Rozo and Sandra Milena Lizcano Zea
Pinilla, González & Prieto



Contents

1. General p.189

- 1.1 Governing Law p.189
- 1.2 Standard Contracts p.189

2. Parties p.189

- 2.1 The Employer p.189
- 2.2 The Contractor p.189
- 2.3 The Subcontractors p.190
- 2.4 The Financiers p.190
- 2.5 The Designer p.190

3. Works p.190

- 3.1 Scope p.190
- 3.2 Variations p.191
- 3.3 Design p.191
- 3.4 Construction p.192
- 3.5 Site p.192
- 3.6 Permits p.193
- 3.7 Maintenance p.194
- 3.8 Other Functions p.194
- 3.9 Tests p.194
- 3.10 Completion, Takeover and Delivery p.194
- 3.11 Defects and Defects Liability Period p.195

4. Price p.195

- 4.1 Contract Price p.195
- 4.2 Indexation p.196
- 4.3 Payment p.196
- 4.4 Invoicing p.196

5. Time p.196

- 5.1 Planning and Programme p.196
- 5.2 Delays p.197
- 5.3 Remedies in the Event of Delays p.197
- 5.4 Extension of Time p.197
- 5.5 Force Majeure p.198
- 5.6 Unforeseen Circumstances p.198
- 5.7 Disruption p.198

6. Liability p.198

- 6.1 Exclusion of Liability p.198
- 6.2 Wilful Misconduct and Gross Negligence p.199
- 6.3 Limitation of Liability p.199

7. Risk, Insurance and Securities p.199

- 7.1 Indemnities p.199
- 7.2 Guarantees p.199
- 7.3 Insurance p.199
- 7.4 Insolvency p.200
- 7.5 Risk Sharing p.200

8. Contract Administration and Claims p.200

- 8.1 Personnel p.200
- 8.2 Subcontracting p.200
- 8.3 Intellectual Property p.200

9. Remedies and Damages p.201

- 9.1 Remedies p.201
- 9.2 Restricting Remedies p.201
- 9.3 Sole Remedy Clauses p.201
- 9.4 Excluded Damages p.201
- 9.5 Retention and Suspension Rights p.201
- 9.6 Termination p.201

10. Dispute Resolution p.202

- 10.1 Regular Dispute Resolution p.202
- 10.2 Alternative Dispute Resolution p.202

Contributed by: Julián Felipe Rojas Rodríguez, David Garzón Gómez, Ángela María Caicedo Rozo and Sandra Milena Lizcano Zea, **Pinilla, González & Prieto**

Pinilla, González & Prieto values gathering knowledge in teams to build comprehensive solutions. The firm generates results supported by a complete understanding, from different perspectives, of the challenges that clients face, and this is reflected in its portfolio of services. Since the mid-1980s, the firm has worked with thousands of individuals and companies (Colombian and international) in different areas of law. This experience and the firm's lawyers are

the base of knowledge that allows it to generate results. To guarantee the comprehensiveness of its services, a team of professionals in architecture, design and urban planning work hand in hand with Pinilla, González & Prieto's lawyers. In addition, this team supports or co-ordinates the technical and financial aspects required by the different areas of the firm. The firm's real estate practice has been ranked in Chambers Latin America for over a decade.

Authors



Julián Felipe Rojas Rodríguez is a corporate lawyer with more than eighteen years' experience, with a law degree from Universidad Externado de Colombia and an LLM in

Corporate and Commercial Law (specialising in insurance) from the Queen Mary University of London. His main areas of expertise are corporate law, M&A and real estate transactions. Throughout his professional practice, he has participated not only in the structuring of several real estate projects throughout the country, but also in its implementation. In the last few years, he has led the corporate law department at Pinilla, González & Prieto Abogados, achieving the fulfilment of important goals and results in the firm.



David Garzón Gómez has a degree in law from the Universidad Colegio Mayor de Nuestra Señora del Rosario and an LLM from Georgetown University Law Center (USA), with a certificate in International Arbitration and Dispute Resolution. His practice focuses on judicial representation in administrative and constitutional contentious actions, representation in state contracting procedures, and advice and support in structuring and subscription of public private associations.



Ángela María Caicedo Rozo has a degree in Law from Universidad de La Sabana. She is also an administrative law specialist from Pontificia Universidad Javeriana and obtained a master's degree in urban and regional planning at the same institution. She practises law focusing on advising on urban law and real estate matters.

COLOMBIA LAW AND PRACTICE

Contributed by: Julián Felipe Rojas Rodríguez, David Garzón Gómez, Ángela María Caicedo Rozo and Sandra Milena Lizcano Zea, **Pinilla, González & Prieto**



Sandra Milena Lizcano Zea has a law degree from Pontificia Universidad Javeriana and is an administrative law specialist from that institution. She also obtained a master's in urban and land planning from the San Pablo CEU University (Spain). Her practice focuses on advising on urban and real estate matters.

Pinilla, González & Prieto

Avenida Calle 72 # 6-30 Pisos 9 y 14.
Bogotá
Colombia

Tel: +57 (601) 210 1000
Fax: +57 (601) 210 1000
Email: pgp@pgplegal.com
Web: www.pgplegal.com



Contributed by: Julián Felipe Rojas Rodríguez, David Garzón Gómez, Ángela María Caicedo Rozo and Sandra Milena Lizcano Zea, **Pinilla, González & Prieto**

1. General

1.1 Governing Law

The laws governing the construction market in Colombia depend on the type of construction that will be developed and the parties involved. Therefore, there are at least three principal groups of laws that apply, the last one applying to all construction practices:

For private and vertical construction:

- [Law 388 of 1997](#);
- [Decree 1077 of 2015](#);
- [Law 84 of 1873](#);
- [Decree 2090 of 1989](#);
- [Decree 410 of 1971](#) (the Commerce Code); and
- [Law 1796 of 2016](#).

For infrastructure and projects required by government entities:

- [Law 80 of 1993](#);
- [Law 1150 of 2007](#); and
- [Law 1508 of 2012](#).

For the commercialisation and liability period of the real estate projects, [Law 1480 of 2011](#).

In general, for labour issues and relationships between employers and contractors, the [Substantive Labour Code](#).

The provisions listed above contain the main regulations for construction in Colombia, but it may be important to review each of the laws that modify the regime, even if the changes are already included in the most recent versions of the aforementioned provisions. Also, there are some other laws regulating more specific and technical matters in construction.

1.2 Standard Contracts

While the use of standard contracts is not mandatory within Colombia, two of the most frequent employers in construction in Colombia, at least in terms of infrastructure, are public entities: the National Roads Institute (INVÍAS) and the National Infrastructure Agency (ANI), which have incorporated standard contracts within their practice. In addition, although not mandatory, these standard contracts have been used by other actors in the market to fill in for issues not foreseen in their private contracts.

These standard contracts, when used, cover the employer-contractor relationship and contractor-designer relationship. They deal less with the contractor-subcontractor relationship, as this usually encompasses case-specific agreements and contractual regulations applicable only on a case-by-case basis.

2. Parties

2.1 The Employer

The entities within Colombia that typically act as employers are, from a public perspective, INVÍAS, ANI and some government ministries such as the Housing Ministry. There are also other entities in the public sphere, such as the Institute of Urban Development (IDU), utility companies, and local authorities such as public works departments in cities.

On the other hand, from a private perspective, construction, infrastructure and real estate companies are the leading employers in construction projects.

2.2 The Contractor

Both infrastructure and real estate companies act as contractors in this jurisdiction. Regard-

Contributed by: Julián Felipe Rojas Rodríguez, David Garzón Gómez, Ángela María Caicedo Rozo and Sandra Milena Lizcano Zea, **Pinilla, González & Prieto**

ing any relationship, from a labour perspective, there is independence between the employer, the contractor and the subcontractor. That is to say, there is no subordination or a labour relationship between them and each company will execute the contract with their own resources. Nevertheless, joint and several liability may arise when there is a breach of the provisions regarding illegal outsourcing. Regarding the financier, there is no risk because provisions regarding outsourcing only apply when the activities developed by the contractor or subcontractor could be seen as part of the object of the financier.

2.3 The Subcontractors

Both infrastructure and real estate companies can act as subcontractors in this jurisdiction.

2.4 The Financiers

Financiers of construction projects are typically: the State, through the entities intended to commission construction projects, private companies, or institutional investors such as pension funds. Usually, the obligations of the financiers are related to the following:

- the control of the execution of the project;
- the possibility of stopping or dividing payments in case of non-compliance;
- in the case of non-compliance by the contractor, the possibility of taking responsibility for the project and executing it itself or assigning it to a third party; and
- finally, and principally, providing the necessary resources for the project according to the contract.

Typically, there is a relationship between the financier and the contractor but none with the subcontractor. In any case, the relationship between the financier and the contractor relies

upon the contract or agreements for the financier to provide the resources for the project.

2.5 The Designer

Usually, the companies who develop this type of activity are private companies, sub-contracted by the infrastructure, real estate companies or even the financier. In that sense on real estate projects it is not common that exist an employer relationship with the designer but a contract for specific designer services.

The general provisions of the design contract are usually:

- the design drawings, specifications, calculations (which the competent planning authority must approve);
- engineering specifications (mechanical, electrical, plumbing);
- compliance with building codes, regulations, and industry standards (Urban Planning, Decree 1077/2015 and NSR10 codes); and
- the functional, technical requirements and aesthetic aspects for the development of the real estate project.

The designer usually prepares the designs and participates in the process itself aimed at approving the specific project in order to make the corresponding adjustments and respond to any observations that may arise.

3. Works

3.1 Scope

For construction contracts between private parties, the purpose and scope of the works are determined depending on the conditions of the specific project. Therefore, the parties will define methods, technical requirements, work specifi-

Contributed by: Julián Felipe Rojas Rodríguez, David Garzón Gómez, Ángela María Caicedo Rozo and Sandra Milena Lizcano Zea, **Pinilla, González & Prieto**

cations and budget, amongst other relevant aspects.

For construction projects involving government entities, the purpose and scope of the contract will be defined by the contracting entity before the opening of the selection process. Colombian law has diverse mechanisms for construction contracts involving government entities, such as those referred to in public procurement laws or those contemplated in regulations for public-private partnerships.

3.2 Variations

In Colombia, the scope and price for variations in construction contracts are typically determined and limited through private contractual agreements between the employer and the contractor. The specific terms and conditions regarding variations are usually outlined in the contract. Three types of contract are prevalent in Colombia:

- fixed lump sum contracts;
- unit price contracts; and
- hybrid contracts.

The variations are dealt with as follows:

- If the employer requests a variation, the scope and price are generally negotiated between the parties; the contractor may submit a variation proposal, including the anticipated changes in scope and associated costs.
- Similarly, if the contractor requests a variation, they typically submit a variation proposal to the employer, outlining the proposed changes in scope and associated costs; the employer reviews the proposal and has the right to accept, negotiate or reject the variation (for instance, an annex is usually

attached to the contract through which a supply is established in contractual relationships).

- It is important to note that specific legal and contractual provisions may differ, and it is advisable to review the meaning under the law for the particular contract terms to fully understand the scope and price determination processes for variations in each construction project in Colombia.

3.3 Design

The responsibilities regarding the design process in construction projects can be divided among multiple parties, including the employer, the designer, the contractor and other stakeholders.

The specific division of work can vary depending on the contractual arrangements and project specifics. However, the typical division of responsibilities is set out below:

The employer:

- defines project objectives and requirements;
- provides project briefs, including functional and technical requirements;
- engages and appoints the designer(s) and other consultants;
- approves and gives necessary information as part of the design process;
- reviews and approves the final design documents; and
- ensures compliance with applicable regulations and permits.

The designer:

- develops the design concept and prepares design proposals;

Contributed by: Julián Felipe Rojas Rodríguez, David Garzón Gómez, Ángela María Caicedo Rozo and Sandra Milena Lizcano Zea, **Pinilla, González & Prieto**

- prepares detailed design drawings, specifications and calculations (which the competent planning authority must approve);
- co-ordinates with other consultants, such as structural engineers and MEP (mechanical, electrical, plumbing) engineers, among others;
- ensures compliance with building codes, regulations, and industry standards (Urban Planning, Decree 1077/2015, and NSR10 codes);
- incorporates the employer's feedback and obtains necessary approvals; and
- provides support during the construction phase, responding to design-related queries and providing clarifications.

The contractor:

- implements the design by executing construction activities;
- reviews the design documents for constructability and feasibility;
- may propose alternative design solutions or value engineering options;
- procures the materials, equipment and labour required for construction;
- manages subcontractors and oversees the construction process;
- collaborates with the designer to resolve design-related issues during construction; and
- ensures compliance with quality, safety and environmental requirements.

Notwithstanding the above, the widespread market practice in Colombia is for the employer to first issue the designs, which must then be revised and modified by the contractor to ensure the viability and correct execution of the project and no further delays due to errors or problems with the designs.

3.4 Construction

Following the provisions of the urban planning regulations, the project developer has the responsibility and obligation to execute residential public service infrastructure that allows the land's adaptation, endowment and subdivision; that is, it must execute the local or secondary network. Likewise, the builder of the building must advance the construction of the internal or intra-domiciliary network of housing units, which is necessary for the effective connection and provision of public services to each housing unit.

The responsible developer oversees execution of the urban planning works, delivery and endowment of assignment areas contained in an urban development licence.

The responsible constructor (builder) is the ideal professional for load-bearing construction works, allowing human habitability under the terms of Colombian law. In this sense, the builder is the professional civil engineer or architect with responsibility for the construction of a building.

3.5 Site Pollution

The responsibility for preventing and mitigating pollution at the construction site is primarily governed by environmental regulations and laws established by the Colombian government, such as the Environmental Licensing Law (Law 99 of 1993) and its subsequent regulations. Therefore, the contractor is generally responsible for implementing measures to prevent pollution and comply with environmental regulations. This includes managing construction waste, implementing proper disposal procedures, controlling emissions and minimising environmental impact.

Contributed by: Julián Felipe Rojas Rodríguez, David Garzón Gómez, Ángela María Caicedo Rozo and Sandra Milena Lizcano Zea, **Pinilla, González & Prieto**

Underground Obstacles

How the presence of underground obstacles, such as utilities or archaeological sites, should be dealt with is regulated by various laws and regulations. For example, the Underground Utilities Protection Law (Law 232 of 1995) protects utility infrastructure during construction activities.

The contractor is typically responsible for identifying and managing underground obstacles during construction. In addition, they are expected to conduct surveys and take necessary precautions to avoid damaging utilities or other underground infrastructure.

Geotechnical Conditions

The responsibility for assessing and dealing with geotechnical conditions is commonly addressed through contractual agreements. The employer and the contractor negotiate and define the scope of geotechnical investigations, testing and any necessary mitigation measures in the contract documents. In addition, the employer often engages a geotechnical consultant to conduct studies and provide recommendations. The contractor relies on this information to plan and execute the construction work under the specified geotechnical requirements approved by Urban Planning Authority.

Archaeological Finds

Finally, in Colombia, archaeological finds are protected by the Cultural Heritage Protection Law and its regulations. These laws require the reporting and preservation of archaeological discoveries. Therefore, if archaeological finds are encountered during construction, the contractor is legally obligated to halt work, report the findings to the relevant authorities and co-operate in preserving the archaeological site as per the regulations. The responsibility for any associ-

ated costs or delays is typically negotiated and defined in the contract.

3.6 Permits

In Colombia, the permits required for a construction process can vary depending on the specific project, location and nature of the construction. However, some common permits typically required include the following:

- A construction licence – this permit grants authorisation to carry out the construction project and is usually obtained from the municipal or local authorities where the construction will take place.
- An environmental licence – projects with potential environmental impacts may require an environmental licence or environmental management plan; this permit ensures compliance with environmental regulations and mitigation measures.
- Urban planning and zoning permits – these permits verify that the construction project aligns with the local urban planning regulations, zoning ordinances and land-use requirements.
- Road occupancy permits – if the construction project involves any road or public space occupation, a road occupancy permit may be required to ensure public safety and minimise disruptions.

The responsibility for obtaining the necessary permits in Colombia is typically shared among multiple parties:

- The employer/project owner is often responsible for initiating the permit application process; they provide project information, engage consultants and co-ordinate with the relevant authorities.

Contributed by: Julián Felipe Rojas Rodríguez, David Garzón Gómez, Ángela María Caicedo Rozo and Sandra Milena Lizcano Zea, **Pinilla, González & Prieto**

- The designers and consultants (eg, architects, engineers and other design professionals) play a role in preparing the necessary documentation and technical reports required for permit applications.
- The contractors collaborate with the employer and designers to provide project-specific information, technical details, and construction plans required for permit applications.

3.7 Maintenance

Maintenance of the works during construction is usually the contractor's responsibility. Once the construction is concluded, and depending on the schemes under which the employer hired the contractor, the parties may agree that the maintenance of the works falls within the scope of activities to be carried out by the contractor under a different and specific contract.

Additionally, construction permits issued in favour of contractors provide specific obligations regarding the maintenance of the works during the construction process, in which case, the permit holder would be the responsible party before the corresponding authorities.

3.8 Other Functions

It is common for the employer to instruct the contractor or third parties regarding other functions in the construction process beyond the scope of the physical construction work. The employer defines the requirements and expectations for these functions, and the contractor or third parties are responsible for executing them according to the given instructions.

It is worth noting that the specific instructions and requirements for operations, finance and transfer can vary depending on the project and the negotiated terms between the parties. However, the contractual agreements between the employer

and contractor usually outline the responsibilities and obligations of these functions, ensuring clarity and accountability throughout the construction process and beyond.

3.9 Tests

The contractor usually carries out tests for completion based on a mutual agreement with the employer or the government entity commissioning for the project. For these purposes, the contractor will generally submit a testing execution schedule defining the items to be tested.

If, because of a test, any facilities, materials or execution are deemed defective or in contravention of the contract and its appendices, the employer may reject the completion by written notice to the contractor, which will either conduct the test again or take any necessary action to fix the defects.

3.10 Completion, Takeover and Delivery

Completion refers to the stage when the construction works have been finished following the agreed-upon contract documents and specifications. It signifies that the physical construction is deemed to be complete and the contractor has fulfilled its obligations.

Takeover, or handover, is the process by which the completed works are formally transferred from the contractor to the employer. It involves the employer assuming control and responsibility for the works, typically through a written agreement or a formal acceptance procedure.

Delivery refers to the act of physically delivering possession and control of the completed works from the contractor to the employer. It may involve handing over keys, access cards, documentation and other relevant items necessary

for the employer to assume control and operate the facility.

These processes are interconnected in the following ways:

- Completion and takeover – completing the construction works is a prerequisite for the takeover process. Once the works are complete, the contractor notifies the employer of the readiness for takeover. The employer, often in collaboration with the designer, inspects the works, verifies their compliance with the contract documents, and determines if they meet the acceptance criteria. If the works are satisfactory, the employer formally takes over the completed works.
- Takeover and delivery – takeover and delivery are closely linked. Once the works have been taken over, the contractor delivers possession and control of the completed works to the employer. This involves the physical handover of keys, documentation and other items necessary for the employer to assume control and commence operations or use the facility.

3.11 Defects and Defects Liability Period

The contractor can be held liable over at least two different periods:

- the period of ten years of ordinary prescription foreseen in the Colombian Civil Code (Law 84 of 1873) for lawsuits against defects in construction, materials or designs; and
- for vertical construction, there is also special protection under the Consumer Statute (Law 1480 of 2011) and the Safe Housing Law (Law 1796 of 2016).

4. Price

4.1 Contract Price

The method used to establish a contract price in Colombia is subject to the free will of the parties to that contract. However, three ways are the most common regarding this determination:

- fixed lump sum contracts;
- unit price contracts; and
- hybrid contracts.

The first transfers the risks of the execution of the contract to the contractor because the employer pays a total amount, not subject to change, for the whole construction process, having the contractor deal with any cost overruns and provide for all the materials, equipment, labour, supervision and any other expense required for the construction.

The second transfers the risk from the contractor to the employer, as the contract's total price is divided into unit prices which may eventually suffer readjustments and affect the final cost of the contract.

Finally, the third combines the first two types, having part of the contract as a fixed lump sum contract but keeping certain elements that are known to be more volatile (eg, those tied to oil prices) under the form of a unit price contract, therefore sharing the risk of the contract between employer and contractor.

Any of these methods can include milestone payments upon completing certain activities or works determined in the contract once certified by the contractor to the employer.

Contributed by: Julián Felipe Rojas Rodríguez, David Garzón Gómez, Ángela María Caicedo Rozo and Sandra Milena Lizcano Zea, **Pinilla, González & Prieto**

4.2 Indexation

Normally, in projects developed by private companies, price control is regulated by the financial model developed for the development of the project, making the indexation of costs and expenses an indispensable item for the calculation.

The risk of price fluctuation is managed contractually, transferring the risk of price increases between the parties, where an unforeseen increase is usually covered by the contractor or the financier, or under the unforeseen events theory.

The concept of “unforeseen events” can be applied if (i) the contract fulfils the necessary criteria for existence and validity, and falls within categories of “successive, periodic, and/or deferred execution” contracts; (ii) an external and entirely unpredictable event that involves the parties happens after the contract’s formation; (iii) this event notably disrupts the contract’s financial performance; and (iv) the debtor was not in default of their obligations. If these conditions are fulfilled, the contract may be subject to judicial review for potential adjustments or termination.

4.3 Payment

The measures used in construction contracts to manage late or non-payment have changed over time. While early models often featured advanced payments, more current regulations have limited the use of this device because of the poor management of that money. Instead, these contemporary regulations prefer interim and milestone payments, in which the construction works are divided into functional units so that the employer pays the contractor once an available unit is finished.

To deal with non-payment or late payment from the employer, contractors usually file lawsuits in the jurisdiction of the contract to achieve recognition of pending interest and/or pending charges. The courts or arbitration panels with jurisdiction depend on the will of the parties and the clauses in the contract. The latter is particularly important because they can include dispute resolution agreements to exhaust negotiation processes before resorting to legal channels.

4.4 Invoicing

In Colombia, there is only one means of invoicing, which is regulated by the country’s tax authority, the National Tax and Customs Directorate (DIAN). Also, in Colombia, the accepted invoicing methodology is electronic invoicing to foster both greater agility in the commercial operations carried out in the country and the cross-checking of information carried out by DIAN.

5. Time

5.1 Planning and Programme

Usually, the employer designs or independently hires someone to design the construction. Then, according to the design, a budget and a schedule are issued. Once the contracting process begins and the employer hires a contractor, these designs are given to the contractor, who has the obligation and exclusive responsibility to identify the adjustments, modifications and/or corrections it deems pertinent and necessary to the studies and detailed designs delivered to it, so that they incorporate those elements that will allow the total and satisfactory execution of the works under the technical specifications governing the contract.

Therefore, the planning is safeguarded by a two-way review of the designs by the parties who

have the greatest interest in there being no cost overruns. The contractor, in particular, would be responsible for these if it did not review the contract with sufficient scrutiny. Milestone payments may be used, but that depends on the structure of the contract and the payment mode agreed upon.

5.2 Delays

In case of delays, the contractor must often make a contingency plan to remedy such delays. Similarly, any negligent execution of the contract by the contractor, which delays the construction and/or makes the construction more expensive, is contractually assumed by the contractor.

Regarding concurrent delays, Colombian jurisprudence has asserted that the unfulfilled contract exception applies in such cases. This means that if both parties simultaneously delay compliance with their obligations, neither is liable. However, if one of them breaches the contract or delays first, the other party is not obliged to fulfil its obligations while being able to enforce compliance from the other party.

5.3 Remedies in the Event of Delays

In case of delays, the most common remedies available to the employer are:

- injunctions;
- notices to correct;
- imposition of fines;
- application of the penalty clause; and
- the possibility of the employer to reassume control of the construction and open bidding for a new contractor.

However, this order is generally progressive because the employer can apply more than one of the above. For example, remedial periods

must usually be opened first to use the penalty clause.

5.4 Extension of Time

Extension of the terms are usually made by the mutual agreement of the parties and, even more, when they involve facts of public knowledge. However, if the circumstances that generate the extension of the term are due to external events in which the parties cannot reach an agreement, they can seek a judge in order to determine it.

As the contracts and designs usually include a two-way review and the possibility for the contractor to change the initial terms made by the employer, there is little possibility for the contractor to request an extension on time without patrimony and liability consequences. Indeed, the contractor, according to its revised designs, issues an operational plan with the time extension of each activity and that of the construction as a whole.

However, the contractor might change the working plan, but only for specific activities, without affecting the deadline of the construction as a whole. Therefore, unless otherwise provided in the contract, only under circumstances of force majeure and unforeseeable circumstances can the contractor request an extension of time without damages. In any other event, the contractor will assume any costs and expenses caused by a delay. The extension of time is usually established according to the time it took for the circumstance and their effects, which caused delays to the agreed timetable, to disappear. In that sense, the extension could be settled at the exact time that the working plan was been delayed.

Finally, the period established for the extension cannot be standardised since discussions in this

Contributed by: Julián Felipe Rojas Rodríguez, David Garzón Gómez, Ángela María Caicedo Rozo and Sandra Milena Lizcano Zea, **Pinilla, González & Prieto**

regard depend on both overcoming the circumstances that generated the request for the extension, and also on the term required to start such activities. therefore, it is necessary to analyse each specific case to be able to determine an extension period.

5.5 Force Majeure

As defined by the Colombian Supreme Court and Colombian statutes, events of force majeure constitute unforeseen events that cannot be resisted, usually coming from irresistible natural events such as earthquakes, tsunamis, shipwrecks or the action of a third party. The key element of such events is that they combine unpredictability with irresistibility by any human means, being external to the party affected. However, it is sometimes possible to exclude events ordinarily considered force majeure from their legal effects, given the specific nature of construction activities. It is also possible to contractually nuance the effects of force majeure. Nevertheless, as the law gives this definition and prevails against contractual clauses, it is impossible to complexly exclude or limit events that can constitute force majeure.

In addition, Colombian law foresees what are commonly known as fortuitous events, whose only difference from force majeure is that the unforeseeable events considered in the latter come as external to the business ordinarily carried out by the affected party, while the events considered in the former are within the activities ordinarily carried out by the affected party. In any case, both force majeure and fortuitous events are regulated in Colombian law and the typical consequences for these events imply an obligation for the contractor to mitigate the effects of the damage to the construction project and to continue to execute those contractual activities not affected by the event. Contractually, the

parties can agree on an additional obligation for the contractor to notify the event considered to be force majeure. Eventually, this type of event might entail the suspension of the contract as a whole or of the contractual activities it affects until the force majeure is overcome. Exceptionally, however, the contract can be terminated if the obligations of any party become legally impossible. Finally, the delays for force majeure events exclude liability for the non-compliance of the party affected.

5.6 Unforeseen Circumstances

Similarly to force majeure events, those involving unforeseeable circumstances have effects on the execution of the contract. Some of them, such as regulatory changes (in obtaining authorisations, environmental licences or prior consultation), have the virtue of changing the schedule of the activities and, eventually, an adjustment in the price of the contract. However, others can be contractually dealt with by assigning the risks of such events.

5.7 Disruption

Disruption is a legal ground for the extension of time or adjustment in the consideration on a contract only if a third party causes it and has the potential to delay the execution of the project and affect the prices in the contract; in this case it is not possible to apply the breach of contract provisions. If the disruption is attributed to any party, breach of contract provisions will apply.

6. Liability

6.1 Exclusion of Liability

Although the possibility of limiting or excluding certain liabilities in the contract is the rule and not the exception under Colombian Law, therefore admitting the modification of liabilities accord-

ing to the will of the parties, there is a specific liability that cannot be excluded. This liability is future “wilful misconduct” (the Colombian equivalent of gross negligence), which according to Article 1522 of the Colombian Civil Code, cannot be excluded by an agreement between the parties or a contractual clause. In addition, another vaguer exception limits the possibility of agreeing to clauses that exclude liability but are contrary to good faith, public order or morals.

6.2 Wilful Misconduct and Gross Negligence

Wilful misconduct and gross negligence concepts exist under Colombian law and are defined in Article 63 of the Colombian Civil Code. Colombian legal doctrine and jurisprudence regard these concepts as essentially the same and prohibit any agreement or pact between the parties with the effect of excluding or limiting future wilful misconduct and gross negligence that might result in liability for the parties.

6.3 Limitation of Liability

The Colombian Civil Code authorises the parties to modify the criteria to impose liability according to their will and convenience. Therefore, the principle of total or integral compensation becomes nuanced. Although Article 1616 of the Colombian Civil Code establishes general rules for the liability of a contracting party that has caused damages to the other, it also states that those rules can be modified through contractual provisions.

The liabilities are usually limited contractually, to the degree and in the cases agreed upon by the contracting parties. However, usually, to guarantee the quality of the construction, the liability of the contractor is rarely limited.

7. Risk, Insurance and Securities

7.1 Indemnities

Indemnities depend on the type of contract agreed between the parties. Traditionally, however, the designer is not responsible for the execution of the project, or indemnities are generated concerning the information given for the fulfilment of a given task (for example, design or construction). Moreover, some indemnities can emerge depending on the risks contractually taken by one party or the other, such as those regarding real estate management, social management or environmental issues. These risks are most evident in infrastructure projects, with environmental issues also crucial in real estate construction because of the land where the project is developed.

7.2 Guarantees

Guarantees vary from public to private works. From a public perspective, there is a crucial one called the *Garantía Única de Cumplimiento*, or single performance guarantee, which entails a guarantee for the correct management of advanced payments, compliance with the contract in the strictest sense, stability in the works and quality in the designs. There are also relevant guarantees regarding the labour obligations of the contractor and non-contractual civil liabilities, which are usually dealt with through insurance and apply to private and public works.

7.3 Insurance

The following are the forms of insurance typically taken out in construction contracts in Colombia:

- insurance for compliance with the contract, for the time of execution of the contract and guaranteeing all of the damages caused by the partial or total non-compliance of the contractor;

Contributed by: Julián Felipe Rojas Rodríguez, David Garzón Gómez, Ángela María Caicedo Rozo and Sandra Milena Lizcano Zea, **Pinilla, González & Prieto**

- insurance of good management of advanced payments, for at least the time of execution of the contract, guaranteeing the correct investment of the total value of the advanced payment;
- insurance for wages, social benefits and labour indemnities to ensure the labour obligations of the contractor;
- insurance for the stability and quality of the construction, guaranteeing any defect or damage within the work;
- insurance against all-risk, insuring any damage in the constructions and machinery; and
- insurance for non-contractual civil liability, guaranteeing the damages that can occur affecting third parties.

7.4 Insolvency

If the contractor becomes insolvent, the employer usually keeps the possibility of reassuming the contract to give it to a solvent third party to continue its execution. Contractual provisions regarding the employer's insolvency are not usually foreseen and are rare in practice.

7.5 Risk Sharing

Typically, risks are undertaken individually and independently in the contract arrangement. However, one widespread practice within the Colombian market is to prepare a matrix of risk in advance to the contracting process. This matrix analyses the risks and states the party that will eventually take each one. It is also crucial because the risks assigned to the parties may determine or affect the contract's price. Therefore, no general provision establishes the risks to be taken by one party or the other. Still, the possibility of assigning the risks as independent or shared between the parties depends on the analysis made in the contracting process. Therefore, which risks are eventually shared depends on the contracting parties will. In that sense,

the risks are not usually shared, but in the case that the parties were interested in it, they could arrange this as they please during the contracting process, taking into consideration the longer construction time, higher value of the project, and change in project conditions.

8. Contract Administration and Claims

8.1 Personnel

The employer has a contractual relationship with the contractor governed by civil and commercial law, not labour law. The agreement is therefore not a labour one. In turn, for the performance of the contract, it is usually stipulated that the contractor shall have adequate, suitable and sufficient personnel for the execution of the contract. The personnel have no relationship with the employer, only the contractor.

8.2 Subcontracting

Construction contracts include the possibility of subcontracting in the contract's performance to fulfil the obligations derived from the agreement. Usually, this possibility is limited in certain aspects, such as requiring previous approval from the employer or being subject to a percentage of the total value of the construction.

8.3 Intellectual Property

Construction contracts can include clauses related to intellectual property that emerges from the performance of the contract. For example, parties can decide who is entitled to ownership and exploitation rights or royalties. Generally, it is agreed that the employer will own those rights, notwithstanding the author's moral rights, which shall remain vested in the creator of the work.

9. Remedies and Damages

9.1 Remedies

In the event of a breach of the construction contract, the following remedies can be applied:

- fines or penalties that the contractor must pay; and
- contingency plans which detail the steps to rectify arrears in the performance of the contract.

9.2 Restricting Remedies

The ability to contractually limit the remedies available for the contracting parties is vast due to the possibility foreseen in Article 1604 of the Colombian Civil Code to exclude or reduce the exposure to liability of any of both parties, except for the cases in which the parties wrongfully agree to condone future wilful misconduct or gross negligence.

9.3 Sole Remedy Clauses

Sole remedy clauses for the complete scope of disputes that may arise from the execution of the contract are rare. However, arrangements may contain clauses obliging the party to resort to a specific remedy if a dispute arises.

9.4 Excluded Damages

Colombian law categorises damages as (i) property damages and (ii) non-pecuniary damages. The former include consequential damage and loss of profit, which must be specific and quantifiable.

Construction contracts do not include non-pecuniary damages, a concept that refers to the injury suffered by a person regarding their feelings, emotions, honour, reputation or physical or mental health, which the judge quantifies

to compensate for the damage experienced by that person.

9.5 Retention and Suspension Rights

Retention clauses are not excluded in this jurisdiction.

Construction contracts can include suspension clauses that restrict the occurrence of certain events, such as:

- force majeure;
- mutual agreement between the parties; and
- other causes established by law.

Nevertheless, other clauses can be included depending on the nature of the parts involved, such as unilateral termination.

9.6 Termination

The legal and contractual possibilities for termination of a construction contract can include:

- the expiration of the term foreseen for the execution of its object;
- the fulfilment of the contractual object;
- the absolute impossibility to comply with the contractual object;
- mutual agreement between the parties;
- a legal and/or judicial order of the last instance against which no appeal is allowed; and
- other causes established by law.

Construction contracts may also include clauses of anticipated and unilateral termination, where the parties determine, case by case, the specific reasons that make these terms applicable.

Contributed by: Julián Felipe Rojas Rodríguez, David Garzón Gómez, Ángela María Caicedo Rozo and Sandra Milena Lizcano Zea, **Pinilla, González & Prieto**

The consequences of such termination are that:

- economic recognition is limited to the amount owed to the contractor for the works constructed until the contract's termination date; and
- a penalty clause in favour of the employer, paid by the contractor for the anticipated termination of the contract due to causes attributable to the contractor.

10. Dispute Resolution

10.1 Regular Dispute Resolution

Colombian procedural law establishes criteria to determine jurisdiction, depending on certain aspects such as the place of execution of the contract or the parties involved.

Civil jurisdiction is competent to adjudicate disputes between private parties in disputes governed by civil and commercial law.

Otherwise, when disputes arise out of contracts executed with government entities under Colombian law, they will be brought before the administrative jurisdiction.

Within these jurisdictions, other factors can affect each court's competence, known as objective, subjective, territorial, functional and connectivity factors.

- Objective: related to the object of the dispute, either in terms of its nature (*ratione materiae*) or its amount (value of the claim).

- Subjective: generated by the characteristics of the persons involved in the litigation (*ratione personae*).
- Functional: derives from the tasks or functions the judge performs; it refers to the different instances, such as the judge that decides an appeal.
- Territorial: defined as the result of the country's division by law into judicial districts so that within the limits of its territorial boundary, an organ may exercise jurisdiction over a specific matter.
- Connectivity: related to the circumstance that a judge, notwithstanding not being competent to handle a case or some of the claims formulated in the lawsuit, may hear them by their accumulation with others where they are competent.

10.2 Alternative Dispute Resolution

Colombian law has recognised diverse mechanisms for alternative dispute resolution (ADR), such as arbitration, conciliation and amicable settlement. These mechanisms can be included in construction contracts, executed between private parties or with government entities, taking into account certain restrictions that apply to the latter. However, in practice, contracting parties usually determine one or more particular types of ADR depending on the specifics of each case due to the differences between each mechanism that can be more suitable or convenient for resolving the dispute.

Trends and Developments

Contributed by:

Juan Manuel González Garavito and Ángela María Caicedo Rozo
Pinilla, González & Prieto

Pinilla, González & Prieto values gathering knowledge in teams to build comprehensive solutions. The firm generates results supported by a complete understanding, from different perspectives, of the challenges that clients face, and this is reflected in its portfolio of services. Since the mid-1980s, the firm has worked with thousands of individuals and companies (Colombian and international) in different areas of law. This experience and the firm's lawyers are

the base of knowledge that allows it to generate results. To guarantee the comprehensiveness of its services, a team of professionals in architecture, design and urban planning work hand in hand with **Pinilla, González & Prieto's** lawyers. In addition, this team supports or co-ordinates the technical and financial aspects required by the different areas of the firm. The firm's real estate practice has been ranked in Chambers Latin America for over a decade.

Authors



Juan Manuel González Garavito is a founding partner at **Pinilla, González & Prieto** and a specialist in administrative law. He is the leader of the urban and real estate law team at the firm

and has been an adviser and consultant in the most significant urban planning and real estate development projects in Colombia and Central and South America. Over more than 20 years, he has been responsible for the legal and financial structure of some of the country's most significant real estate projects. In addition, he is a recognised expert in the design of financing mechanisms such as the burdens and benefits system.



Ángela María Caicedo Rozo has a degree in Law from Universidad de La Sabana. She is also an administrative law specialist from Pontificia Universidad Javeriana and

obtained a master's degree in urban and regional planning at the same institution. She practises law focusing on advising on urban law and real estate matters.

Pinilla González & Prieto

Av. Calle 72 # 6 – 30 pisos 9 y 14
Bogotá D.C.
Colombia

Tel: +57 (601) 2100 000
Fax: +57 (601) 2100 000
Email: pgp@pgplegal.com
Web: www.pgplegal.com



Urban Planning in Colombia Today: An Overview

It is important to highlight two aspects that currently have a great impact on the development of the territory, influencing the possibilities of use or establishing special restrictions that result i) on the one hand, from the need to articulate national and municipal regulatory provisions in response to the new regulatory framework referring to the determinants of territorial planning defined in the National Development Plan (PND), and ii) on the other hand, from the evolution of the housing market in the face of new demands regarding tourism.

Effects of the new determinants of territorial planning regarding the changes introduced by the National Development Plan (PND)

Article 32 of the National Development Plan (PND) (Law 2294 of 2023) amended Article 10 of Law 388 of 1997 on determinants of territorial planning, creating new rules and originating an order of prevalence that is worth analysing from the perspective of its effects on Territorial Planning Plans (POT), Basic Land Use Plans (PBOT), Land Use Schemes (EOT) and their management instruments. It should not be forgotten that the determinants of territorial planning constitute rules of higher hierarchy for the preparation and adoption of the POTs and, therefore, the precise definition must be set prior to processing the plan and its adjustments or modifications.

The current POT, PBOT and EOT in each municipality or district, or their adjustments and modifications, should have been issued based on the regulatory determinants in force on the date of their preparation and adoption; that is, those indicated in Article 10 of Law 388 of 1997. In this sense, all land management instruments or zoning plans, such as Partial Plans, macro-projects, comprehensive urban actions, Zonal Planning Plans or Rural Planning Units that are in execution or in the process of adoption, based on the current POTs, must be adopted and executed within the legal framework of these and not of new administrative acts that define the determinants of planning created in the PND.

On the other hand, all of these determinants come from authorities other than the one that has the constitutional competence for planning the territory in the exercise of territorial autonomy. This means that any exercise in the state that indicates they must be rigorous, in the extreme, in the technical and scientific support of their implementation, because they ultimately limit municipal competence in the formulation and adoption of their POTs.

The role of the Constitutional Court in the analysis of the determinants of territorial planning requires high technical and scientific standards.

In this regard, all the determinants indicated in article 32 of the PND must be carefully reviewed by the Constitutional Court, which, in application of the corresponding constitutionality tests, will show whether any of them violates the principle of territorial autonomy or whether, on the contrary, they are the product of the application of the principle of harmony in the exercise of constitutional powers among the national, local and environmental authorities.

In the case of those that are constitutionally valid and that respond to a vision of territorial planning – based on determinants that allow a balanced development between the competencies of the municipalities or districts and the other authorities set forth in article 32 of the PND – it is necessary to provide support of the highest technical quality, with legal certainty for all actors and that originates their peaceful incorporation into territorial planning.

For example, in the case of the first level of determinants, ie, those related to conservation – the protection of the environment and ecosystems, the water cycle, natural resources, the prevention of disaster threats and risks, the management of climate change and food sovereignty – there must be, in the first instance, a normative definition of the national order on the scope, application and the terms and conditions.

It must be followed with a technical and scientific depth that identifies these lands with such precision that their incorporation in the territory is reflected in geographical co-ordinates, specific areas and precise delimitation, otherwise, it could affect the constitutional right of the municipality to make decisions about its territory.

Under this premise, the other determinants must be complied with, for which the municipalities

or districts have the right and obligation to their citizens to demand from the nation, the Regional Autonomous Corporations (CAR) and the other competent entities in the matter, the greatest degree of technical and scientific depth at the time of establishing them.

On the subject, it is worth making a brief analysis of the determinant incorporated in level 2: “The areas of special interest to protect the human right to food of the inhabitants of the national territory located within the agricultural frontier, in particular, those included in the Protection Areas for food production, declared by the Ministry of Agriculture and Rural Development (...)”. This is included in the PND and grants a very broad decision-making power over the use of the land, headed by the Ministry of Agriculture, since it allows an entity of the nation itself, the Agricultural Rural Planning Unit (UPRA), to establish the criteria for its declaration in each territorial entity.

In other words, it is the same ministry, on the basis of the UPRA criteria, that declares the zones. This decision is taken without the participation of the municipal or district authority or the owners of the land who surely have other farms legitimised by the current POT, including agricultural and livestock farms.

Regardless of the rigorous examination that the Constitutional Court must carry out on the determinant, the Ministry of Agriculture has a significant challenge in the extreme care that it must implement in the decisions that are adopted, since any position must be well supported by technical and scientific studies that allow us to be certain that this limitation on the land obeys a real need and is not the result of political interests.

For the time being, it is worth emphasising that, like all Colombian legal rules, the planning deter-

minants do not produce retroactive legal effects. Consequently, they cannot affect legal situations consolidated under the rules in force for their holders. To do so, as the Constitutional Court has stated, it must be in the presence of a collective superior interest and compensation must be paid for the unlawful damage caused to the owner of the land.

Tourist housing as alternatives for economic exploitation

With the need to reactivate the construction sector on the table, it is necessary to understand development alternatives, within the framework of the current regulations.

In accordance with the competence assigned by Law 388 of 1997, municipalities and districts are autonomous to define in the territorial planning plans or in the instruments that develop and complement them, the specific uses and other urban planning regulations of the territorial properties assigned to them. This includes allocating so-called “main uses”, “conditioned uses” and “prohibited uses” to specific areas of activity, among others.

Thus, in order for a project to be developed in a specific property, it must first be confirmed that the required use is authorised and whether as a main, complementary or conditional use, taking into account the conditions required for implementation of conditional use.

One of the cases of special regulation are National Decrees 2590 of 2009, 1074 of 2015 “DUR of the commerce, industry and tourism sector”, and Law 2068 of 2020 “By which the General Tourism Law is modified”, which have created and developed the concept of Tourist Housing. This is defined as the real estate unit destined in its entirety to provide the accommo-

dation service according to its capacity, to one or more people, which may have complementary services and should include at least a bedroom, a kitchen and a bathroom.

As can be seen with the previous definition, the architectural configuration of tourist housing in the Colombian standard does not differ from the basic elements of housing in its conventional use. A situation that, based on the legal definition, allows us to affirm, as will be explained later, that this use can occur in new or old constructions whose main use is housing.

The law explicitly indicates that tourist apartments, tourist properties and other properties whose destination corresponds to this definition, belong to this classification.

Natural or legal persons who offer this service on their properties must register in the National Tourism Registry, under the terms of Decree 2590 of 2009, which constitutes an official database through which the national government can formulate studies and get indicators on the behaviour of the tourism sector at the national and international level. This allows for defining policies, plans and programmes, as well as monitoring tourism activity in the country.

This special form of economic exploitation of residential properties has been enhanced in recent years by new dynamics of global tourism, in which travellers not only look for a hotel room, but also spaces that have other types of amenities such as broader private ones, social spaces and larger rooms, in addition to independent service areas such as a laundry, kitchen and other elements more typical of conventional housing.

Likewise, the possibility of teleworking, which has been constantly growing after COVID-19,

has increased the demand for temporary accommodation with much longer stays than those offered by hotels or traditional accommodation services.

Colombia has special qualities that have made this new type of accommodation very popular throughout its geography. The country's tourism potential has caught the attention of thousands of people who see Colombian cities as a place to develop their lives and businesses within the framework of this new reality and who consequently demand this type of innovative spaces for social dynamics of the territories, which represents a special challenge for territorial planning, articulating traditional land uses with this form of economic exploitation within the framework of residential use.

Likewise, the growing demand for this service has generated a new investment scenario in the housing segment, which ends up being a growth opportunity for the construction sector in the midst of the current panorama.

In this sense, it is relevant to point out that without prejudice to the territorial autonomy and differential denominations of the uses purely of hotel services, tourist housing does not constitute a use of land other than residential use, since it is a special form of economic exploitation of housing within the framework of the autonomy of will.

Therefore, for the purposes of investigating the possibility of this type of exploitation, the authorisation for residential use must be validated to ensure that it is indeed in place and that in the case of developing it for tourist purposes, the type of property, the regime of uses, the quality of the provider, the duration of the stay, the minimum architectural conditions and the necessary

registrations for the operation must be determined, as is the case with the National Tourism Registry in accordance with Law 1101 of 2006. It also must be evaluated whether the execution of this activity on a recurring basis merits the condition of merchant use in accordance with the provisions of article 10 of the Commerce Code.

In addition to the above, it should be noted that the civil and commercial legislation in force does not provide for any prohibition for the purchaser of a home to enter into lease or lodging contracts, so that, by virtue of the principle of the autonomy of private will, residential units may be operated without prejudice to the fact that special care is taken to comply with the special characteristics of the accommodation contract, so that it does not blur the meaning between that and an urban housing lease contract.

These conclusions derive from the reading of national regulations; however, it is necessary to understand how this concept is adopted in each territorial entity, blurring the exploitation itself, in definitions that have been framed interchangeably as commerce, services, residential or hotel land use, among others, or that arbitrarily established additional conditions to those established in the national standard for the constitution and operation of this type of economic exploitation, which is why harmonisation of these concepts is urgently needed. This also facilitates the approval of urban planning licences, the marketing of the units and the correct regulation in cases of submission to horizontal property to avoid future interpretations.

Likewise, within the due diligence carried out for the execution of projects that are marketed for this economic purpose, the special conditions that each local regulation establishes regarding this use must be studied.

DENMARK

Law and Practice

Contributed by:

Christian Johansen, Liv Helth Lauersen, Christian Taksøe and
Christopher Vitoft Ångström

Bruun & Hjejle



Contents

1. General p.212

- 1.1 Governing Law p.212
- 1.2 Standard Contracts p.212

2. Parties p.213

- 2.1 The Employer p.213
- 2.2 The Contractor p.213
- 2.3 The Subcontractors p.213
- 2.4 The Financiers p.213
- 2.5 The Designer p.214

3. Works p.214

- 3.1 Scope p.214
- 3.2 Variations p.214
- 3.3 Design p.215
- 3.4 Construction p.216
- 3.5 Site p.216
- 3.6 Permits p.217
- 3.7 Maintenance p.217
- 3.8 Other Functions p.217
- 3.9 Tests p.217
- 3.10 Completion, Takeover and Delivery p.218
- 3.11 Defects and Defects Liability Period p.218

4. Price p.219

- 4.1 Contract Price p.219
- 4.2 Indexation p.219
- 4.3 Payment p.220
- 4.4 Invoicing p.220

5. Time p.220

- 5.1 Planning and Programme p.220
- 5.2 Delays p.221
- 5.3 Remedies in the Event of Delays p.221
- 5.4 Extension of Time p.222
- 5.5 Force Majeure p.222
- 5.6 Unforeseen Circumstances p.222
- 5.7 Disruption p.223

6. Liability p.223

- 6.1 Exclusion of Liability p.223
- 6.2 Wilful Misconduct and Gross Negligence p.224
- 6.3 Limitation of Liability p.224

7. Risk, Insurance and Securities p.224

- 7.1 Indemnities p.224
- 7.2 Guarantees p.224
- 7.3 Insurance p.225
- 7.4 Insolvency p.225
- 7.5 Risk Sharing p.226

8. Contract Administration and Claims p.226

- 8.1 Personnel p.226
- 8.2 Subcontracting p.226
- 8.3 Intellectual Property p.226

9. Remedies and Damages p.226

- 9.1 Remedies p.226
- 9.2 Restricting Remedies p.228
- 9.3 Sole Remedy Clauses p.228
- 9.4 Excluded Damages p.228
- 9.5 Retention and Suspension Rights p.228
- 9.6 Termination p.228

10. Dispute Resolution p.229

- 10.1 Regular Dispute Resolution p.229
- 10.2 Alternative Dispute Resolution p.229

Contributed by: Christian Johansen, Liv Helth Lauersen, Christian Taksøe and Christopher Vitoft Ångström, Bruun & Hjejle

Bruun & Hjejle has three very experienced partners in its construction team – Christian Johansen, Liv Helth Lauersen and Signe Direrks Bakkeng– as well as 12 attorneys and eight assistant attorneys. The office is located in Copenhagen, Denmark, but often deals with cross-border disputes, while projects with international scope are handled in co-operation with a network of law firms in other jurisdictions. The construction team, ranked in Chambers Band 1, advises Danish and international clients on legal matters relating to the building and con-

struction sector and its members are legal advisers on many of the largest and most high-profile construction and infrastructure projects in Denmark. The team advises clients on disputes arising during the execution of large and complex construction projects and has extensive litigation experience and knowledge within strategic planning and accommodation of commercial considerations, which are often at play in the handling of disputes during or after the construction phase.

Authors



Christian Johansen has 25 years' experience as a construction lawyer, which includes the drafting of international commercial contracts and acting as counsel

in construction disputes, including international arbitration. Christian's work covers domestic and international construction contracts in the areas of infrastructure, energy, offshore and construction insurance, and he regularly acts in litigation, mediation and arbitration. He became a partner at Bruun & Hjejle in 2012, managing partner in 2023, and is a member of the Chartered Institute of Arbitrators in London. Christian is presently one of only three lawyers in Denmark ranked in Chambers Band 1 within construction. He is also a published author.



Liv Helth Lauersen is a leading profile in construction and contract law and has extensive experience advising domestic and international clients. Liv is consistently engaged to handle

leading court and arbitral cases, adeptly representing owners, contractors and advisers alike. At Bruun & Hjejle, Liv draws upon a solid breadth of knowledge and experience in all stages of the construction process, ranging from initial negotiations of contracts and subcontracts to the performance thereof, along with handling matters of contract interpretation, calls on bonds and guarantees as well as dispute resolution in all its facets.

Contributed by: Christian Johansen, Liv Helth Lauersen, Christian Taksøe and Christopher Vitoft Ångstrøm, Bruun & Hjejle



Christian Taksøe is an experienced lawyer specialised in construction law and dispute resolution in general. He advises domestic and international clients on matters related to

construction law and in all stages of the construction process, including tender and negotiation of contracts, contract and project management, insurance-related matters, call on guarantees, and the handling of disputes. Christian is renowned for his work on large and complex construction and infrastructure projects. He acts as counsel in arbitration and litigation and is involved in several leading cases. Christian started at Bruun & Hjejle in 2013 and has in an interim period worked as an assistant judge at the Danish Supreme Court.



Christopher Vitoft Ångstrøm is a rising profile within construction, infrastructure, and offshore projects. He particularly focuses on, and has experience with, advising on large-scale

projects, domestically and internationally. Christopher acts as counsel on projects from the initial contract negotiations and through the ongoing contract management, where he advises on the Danish AB-suite of contracts, the FIDIC suite of contracts, Orgalime, and bespoke contracts. Christopher regularly acts as counsel in arbitrations both during and following projects. He started at Bruun & Hjejle in 2016 but has had interim experience as an in-house attorney working on major renewable energy projects within EU, US, and APAC.

Bruun & Hjejle

Nørregade 21
1165 Copenhagen K
Denmark

Tel: +45 33 345 000
Email: chj@bruunhjejle.dk
Web: www.bruunhjejle.dk

BRUUN & HJEJLE

Contributed by: Christian Johansen, Liv Helth Lauersen, Christian Taksøe and Christopher Vitoft Ångström, Bruun & Hjejle

1. General

1.1 Governing Law

In Denmark, there are no laws specifically governing the contractual relationship between an employer and a contractor. Instead, there are several standard contracts that have the status of agreed documents and on which virtually all large construction contracts are based, see **1.2 Standard Contracts**.

With regard to statutory requirements related to buildings and constructions, this is mainly governed in the Danish Building Act and the relevant ministerial orders.

Furthermore, the Danish Contracts Act regulates, inter alia, when and how a contract is agreed and binding. It also contains certain principles of interpretation.

1.2 Standard Contracts

As mentioned in **1.1 Governing Law**, large construction contracts are usually based on a suite of standard contracts governing the relationship between the employer-contractor, employer-designer, contractor-subcontractor and contractor-designer, called the AB Standards. However, the use of standard contracts is not mandatory.

Construction contracts in Denmark are rarely based on NEC3 or the like, due to the availability of the aforementioned standard documents, which are somewhat comparable to the standard documents used in other parts of Scandinavia (Sweden and Norway). The use of FIDIC contracts is significantly less than the use of the AB Standards. However, in particular sectors, namely large multinational contracts, contracts on renewable energy, and contracts on offshore works, FIDIC contracts are the predominant choice or advancing significantly.

The AB Standards

The Danish standard documents, the “AB Standards” are agreed documents, meaning that they have been prepared based on, inter alia, negotiations between opposing interest groups. A committee appointed by the Danish Minister for Climate, Energy and Building (and containing representatives from the interest groups) has formulated three standard contracts (the “AB Standards”) for use in construction in Denmark.

- AB 18 – General conditions for building and construction works and supplies (“AB 18”). AB 18 is used in the relationship between an employer and a contractor where, by and large, the contractor is responsible for the performance of the building and construction works, and the employer is responsible for the design.
- ABT 18 – General conditions for design-and-build contracts (“ABT 18”). ABT 18 is also used in the relationship between an employer and a contractor, but covers those situations where the contractor is responsible for the performance of the building and construction works as well as being responsible for the design.
- ABR 18 – General conditions for consultancy services for building and construction works (“ABR 18”). ABR 18 is used between an employer/contractor and a consultant.

The AB Standards are sets of general conditions, setting out the parties’ contractual rights, obligations and responsibilities and are used alongside the parties’ construction contract, which is often brief, as well as the employer’s/contractor’s requirements, time schedule and other contractual documents.

Though the AB Standards are, to some extent, a codification of generally applicable Danish legal

Contributed by: Christian Johansen, Liv Helth Lauersen, Christian Taksøe and Christopher Vitoft Ångström, Bruun & Hjejle

principles, the AB Standards only apply if the parties have agreed thereto.

2. Parties

2.1 The Employer

In Denmark, the entities acting as employers in construction projects vary greatly. Common entities are the Danish state, often represented by governmental authorities, bodies or agencies, regional authorities and municipalities, as well as co-operative housing societies. Similarly, the private sector plays a large role, and is responsible for around two-thirds of the total investments.

Under a construction contract, the rights and obligations of the employer depend, of course, on the specific contract entered into. However, generally, during the contract conclusion period, the employer:

- calls for tenders based on tender material;
- obtains the necessary approvals for the construction;
- ensures design for the construction;
- takes out certain insurances; and
- provides security for payment to the contractor(s).

During the construction phase, the employer has a number of management and control obligations and rights towards the contractor, as detailed in the AB Standards. The primary, however, being to pay the contract sum for the contractor's performance.

2.2 The Contractor

Companies that typically act as contractors may be divided into large construction groups, specialising in design-and-build contracts, and specialised contractors who focus on certain

fields of construction and therefore often act as subcontractors to design-and-build contractors.

Under a construction contract, the rights and obligations of the contractor depend on the specific contract entered into. However, generally, during the contract conclusion period, the contractor is responsible for the planning and execution of the works and has, unless otherwise agreed, freedom of choice as to how the works are to be performed (see **3. Works**). Besides performing the works, a contractor must usually provide security (often a performance bond) for fulfilment of its duties towards the employer, take out liability insurance, deliver materials, prepare and update working schedules, etc.

2.3 The Subcontractors

Subcontractors are typically companies with specialist knowledge in a specific area; typical examples are the so-called technical (sub)contractors, specialising in areas such as ventilation, electricity, and plumbing and heating.

Contractually speaking, a design-and-build contractor is – vis-à-vis its subcontractors – considered an employer in Denmark. The general rights and obligations of the subcontractors are therefore comparable with the rights and obligations of the contractor towards the employer.

2.4 The Financiers

Construction projects in Denmark are most commonly financed by private banks, pension funds and public entities.

The financiers are not a party to the construction contract but have an independent contractual relationship with the relevant party. As such, the financiers have no direct rights or obligations under the construction contract, besides those

following from guarantees issued by the financiers.

Any control or rights would therefore have to be agreed upon in the contract between the financier and the debtor. As an example, the financier may have an interest in novating the construction contract if the employer goes bankrupt. Such right to novate an agreement must generally be agreed upon in advance under the construction contract between the employer and the contractor.

2.5 The Designer

The consultancy industry has evolved over the past several years towards having large organisations, which can deliver within most or all areas of the design of a construction project, encompassing both architectural and technical consultancy. Additionally, there are other, typically larger, companies that focus more on individual services within the design of a construction project, whether it be architecture, engineering services, or other consultancy services. However, the industry still has a large number of small or medium-sized companies, which are specialised in particular design tasks, inter alia, due to the vast need for special knowledge on individual aspects of construction projects.

The rights and obligations of the designer are dependent on the specific construction contract. In a general sense, the designer is responsible for delivering a project, or a part of a project, which is buildable. The designer has a contractual relationship to either the employer or the contractor, based on who has the obligation to design the project.

3. Works

3.1 Scope

Given the freedom of contract, the scope of work can be determined in any way the contractual parties agree. Essentially, the scope of work is determined by the employer in the tender documents, either in the form of certain functional requirements to be achieved or in the form of a more detailed set of specifications, depending on the type of contract. Such scope of work is subject to agreement (potentially after negotiations) with the contractor(s).

When the contract is concluded, the scope of work is (in theory) set, and any additional work or changes thereto may entail that the contractor is entitled to additional payment and time.

Whereas the requirements regarding the work to be performed tend to be categorised as functional or performance requirements in design-and-build contracts (ABT 18), the requirements regarding the work tend to be more specified in other construction contracts (AB 18).

3.2 Variations

Employer's Rights

In accordance with the AB Standards, the employer has a right to order variations to the works when such variations are naturally linked to the services agreed upon.

An example of a variation could be that the contractor must supply a service in addition to, or instead of, the originally agreed service. However, a change in the nature, quality, type or execution of a service may also be considered a variation.

The employer's right to order variations is not unlimited. As stated above, it is a requirement

Contributed by: Christian Johansen, Liv Helth Lauersen, Christian Taksøe and Christopher Vitoft Ångström, Bruun & Hjejle

that the variation is naturally linked to the services agreed.

Rights of the Contractor

It is also worth noting that – to balance the contractor's interest – the contractor has a right to carry out (and be paid for) variations demanded by the employer, unless the employer proves that there are special reasons for having another contractor perform the work. Such special reason may, inter alia, be that the contractor does not have the necessary technical knowledge to perform the variation or that the payment requested by the contractor is unreasonable. As such, the employer cannot simply engage a new contractor to perform work that is naturally linked to the works that the already-engaged contractor has performed on a project.

Determining the Price

With regards to determining the price of the variation, this depends on the specific AB Standard entered into, but pricing is commonly either done based on unit rates agreed in the contract or on an account basis. With regard to the latter, the contractor may claim what is reasonable, and it is up to the employer to prove that the claimed price is unreasonable.

Time-Related Costs

The contractor may claim time-related costs caused by a variation ordered by the employer. Conversely, if the variation order entails a cost saving compared to what was originally ordered, the employer may be entitled to a reduction in price.

3.3 Design

The responsibilities regarding the design process between the employer, the designer, and the contractor depend on the parties' agreement and may be construed with many nuances and

hybrids. However, some general starting points can be discerned from the AB Standards.

AB 18 – Contractor Only Carries Out the Building and Construction Work

If AB 18 is agreed, the employer and the contractor have – as a starting point – agreed that the contractor “only” carries out the building and construction works, and that the employer is responsible for the design (drawings, descriptions, etc).

In such cases, the employer bears the full responsibility for the design, and the contractor is only to carry out design work if this has been agreed.

With an AB 18 set-up, the employer will usually enter a contract with a designer/consultant to carry out the designs on behalf of the employer – such contract is usually based on an ABR 18, see **1.2 Standard Contracts**. The designer/consultant will then be responsible for the design in the contractual relationship between the employer and the designer/consultant.

ABT 18 – Contractor Carries Out the Building and Construction Work and Design (Design and Build)

The employer and contractor can agree that the contractor carries out the building and construction works and supplies the design. ABT 18 is relevant for this type of agreement, see **1.2 Standard Contracts**.

In such cases, the contractor bears the full responsibility for the design in the relationship between the employer and the contractor. However, if the employer has proposed a specific type of design in the tender documents and the design is applied, then the contractor may not be responsible for this design.

Contributed by: Christian Johansen, Liv Helth Lauersen, Christian Taksøe and Christopher Vitoft Ångstrøm, Bruun & Hjejle

The contractor will, in such instances, often enter a contract with a designer/consultant to carry out the design (based on ABR 18), and the designer/consultant is therefore responsible for these designs in the relationship between the contractor and the designer/consultant.

3.4 Construction

The division of responsibilities in the construction process between the employer and the contractor(s) depends on which AB Standard has been agreed, namely AB 18 or ABT 18.

To give an example, some of the employer's and contractor's main responsibilities during the construction process (after the design phase) in an AB 18 set-up may be described as the following.

Employer's Responsibilities

The employer is responsible for:

- relations with the authorities, including achieving the necessary approvals, etc;
- preparing the master programme;
- managing interfaces;
- appointing a supervisor to represent the employer in its relationship with the contractor;
- convening construction meetings with the contractor; and
- calling the parties to attend a pre-handover review of the works, as well as the actual handover meeting.

Contractor's Responsibilities

The contractor(s) is responsible for the work performed, namely, that the work is performed in accordance with the contract (the design, possible requirements, etc), but also more generally that the work is done in accordance with good professional practice. If the work is not performed in accordance with the contract or

good professional practice, that work is considered defective.

The contractor is, as a starting point, also responsible for preparing a work schedule (based on the master programme), which states the sequence of the individual elements of the contractor's work, including assessing compliance with this schedule on an ongoing basis. The contractor is further responsible for quality assurance of its services.

The above-described division of responsibilities may, however, be amended as the parties see fit, and the possible division of work is therefore completely up to the parties concerned.

3.5 Site

Information About Obstacles at the Construction Site

Regarding the status of the construction site, the tender document must include information about surveys and studies made concerning ground-water and soil conditions, pollution, pipes, cables, hazardous substances and materials, as well as any other obstacles. This follows from both AB 18 and ABT 18. Thus, the employer is responsible for inspecting the construction site, unless otherwise stated in the contract between the employer and the contractor.

If the contractor finds that the work cannot be performed in accordance with the contract due to obstacles, the contractor must notify the employer immediately and await instructions.

Public Enforcement Notices or Prohibitions

It is also worth noting that the authorities are entitled to issue public enforcement notices or prohibitions. This is the case if something at the construction site does not fulfil, for example, regulatory requirements for pollution, or if

archaeological finds are discovered at the site. The employer bears the risk for such notices or prohibitions unless they have been issued as a result of the contractor's actions.

3.6 Permits

Most construction projects require a building permit, which is issued by the local municipality upon the employer's application, before the construction process begins. The permit is only given if the construction project is in accordance with Danish building regulations and the local development plan, if applicable.

Upon completion of the construction project, the employer must apply for an occupancy permit before using the new building. The occupancy permit is given by the municipality after receiving all the relevant documents, including a declaration stating that the construction work has been carried out in accordance with the building permit and the building regulations.

The building permit and the occupation permit are governed by mandatory law (Danish Building Act).

As of 2023, the majority of new heated buildings must at completion have a Life Cycle Assessment (LCA) stating the building's yearly CO₂ emissions per square metre over a 50-year period in order to obtain an occupancy permit. Most heated buildings larger than 1,000 square metres must abide by the threshold limit value currently set at 12kg CO₂ equivalents per square metre per year, in order to obtain occupancy.

3.7 Maintenance

The contractor bears the risk of damage to, or loss of, works and materials until the work has been handed over to the employer – see **1.2 Standard Contracts**, AB 18 and ABT 18.

Contractor's Responsibilities

The contractor is, therefore, also responsible for maintenance of the works during the construction. While the contractor obviously has an interest in taking care of the works during the construction, it is essentially up to the contractor how this obligation is fulfilled.

Employer's Responsibilities

When the work has been handed over, the employer is responsible for damage to and loss of works and materials, as well as maintenance. During the construction process, the employer is also responsible for damage to or loss of works if the damage or loss is due to circumstances relating to the employer. If the work or part thereof is taken into use before the handover, the employer is also responsible for any loss or damage to the work occurring thereafter.

3.8 Other Functions

Other functions in the construction process such as operation, finance or transfer are usually not instructed by the employer to the contractor or third parties. Exceptions do occur, however – for example, in large infrastructure projects.

3.9 Tests

Before providing a few notes on the tests for completion of works in Denmark, it is important to note that the relevant time for evaluating whether a work is defective is the time of handover.

The quality of the works will therefore be assessed during the handover meeting, but actual tests are usually not part of the ordinary handover meeting.

This must be viewed in light of the fact that construction contracts often include provisions requiring the contractor to perform certain qual-

Contributed by: Christian Johansen, Liv Helth Lauersen, Christian Taksøe and Christopher Vitoft Ångström, Bruun & Hjejle

ity assurance of the works, including the design, as well as provisions on samples or tests to be taken prior to handover. The result of such tests will therefore be part of the contractor's quality assurance documentation, submitted to the employer on an ongoing basis prior to handover.

3.10 Completion, Takeover and Delivery

As a new rule in the AB Standards (revised in 2018), the parties must – prior to the actual handover of the works – conduct a pre-handover review.

Pre-handover Review

The purpose of conducting a pre-handover review is to support a continuous inspection for defects and to align the parties' expectations.

Prior to handover of the works, the employer must summon the parties to attend a review of the works (all or sections thereof) in reasonable time before the agreed handover date. At the pre-handover review, the employer prepares a protocol stating all matters identified, and any remarks made by the contractor. If the identified matters are considered defects by the employer (and the contractor), the contractor will agree to rectify the identified defects. The fact that a matter has not been identified by the employer at the pre-handover review does not preclude the employer from later raising the matter as a defect.

The Actual Handover Meeting

Immediately before the completion of the works, the contractor must give the employer a notice of completion, after which the employer will summon the contractor for the actual handover meeting. Once the handover meeting has been held, the works are considered handed over to the employer, unless material defects are identified at the meeting. Material defects will particu-

larly be matters preventing the employer's use of the works to a significant extent.

At the handover meeting, the employer prepares a handover protocol in which the defects and other matters identified are stated. In addition, the parties agree on the methods and deadlines for the rectification of the defects. The handover protocol will state whether the works are considered handed over.

3.11 Defects and Defects Liability Period

Defects Liability Period in Accordance With the AB Standards

Inspection of the works is made at the handover, one year after the handover, and again five years after the handover. The purpose of these inspections is to enable the parties to identify any defects together.

An absolute deadline to present claims regarding defects detected is also regulated in the AB Standards; ie, the employer's claims must be submitted no later than five years after handover of the works, after which the contractor's liability for defects generally ceases. Exceptions may be made where the contractor has given a guarantee, the quality assurance process has materially failed, or the contractor has acted in a manner that is grossly negligent.

Danish Statute of Limitations Act

In Denmark, it follows from the Danish Statute of Limitations Act that a claim becomes statute-barred three years after the claimant became or should have become aware of the circumstances giving rise to the claim. This applies in parallel with the rules in the AB Standards.

The limitation period may be suspended by, for example, mutual agreement, or by taking legal action to pursue the claim.

Contributed by: Christian Johansen, Liv Helth Lauersen, Christian Taksøe and Christopher Vitoft Ångström, Bruun & Hjejle

Acquiescence Resulting in the Forfeiture of Rights and Failure to Notify of Defects

According to Danish case law, the employer may lose an otherwise entitled claim in respect of defects against the contractor if the employer, for example, fails to notify the contractor within a reasonable period of time after the defects were or should have been discovered (even though the claim is presented within the five-year period). Likewise, the employer may lose its claim if the employer's behaviour and conduct give the contractor a reasonable expectation that the claim does not exist or has been forfeited. These principles apply in parallel to the AB Standards and the Danish Statute of Limitations Act.

4. Price

4.1 Contract Price

In Denmark, the contract price can either be a fixed price, on account or a combination of these. The most common way of establishing the contract price is by using a fixed price. However, this will depend on the parties' agreement.

In general, the contract price includes all services and materials necessary for the contractor's completion of the scope of works. The contractor's offer, including the price, is based on the employer's tender provided to the contractor as a basis for the preparation of the offer. In this way, it is essentially up to the contractor to establish the contract price – assuming, of course, that the employer accepts the offer.

In relation to payments, the contractor is entitled to receive payment twice a month for any works performed and materials delivered to the construction site, in accordance with the AB Standards. However, the parties may instead agree that payment is to be made in accord-

ance with a payment schedule, stipulating the dates or milestones at which a certain percentage of the contract sum falls due for payment, provided that the progress of the works at that time is as planned.

4.2 Indexation

Pursuant to the AB Standards, the contract price is subject to indexation for the works performed more than 12 months after the tender date. The parties can choose and agree on a specific index, and if nothing is agreed, the price is adjusted in accordance with the building or construction cost index which is considered relevant to the works. If the parties cannot agree on the index, ultimately, this may be subject to arbitration or litigation.

The indexation is calculated by linear interpolation and determined by the change in index from six months after the date of the tender and until the time of performance of the relevant work, by using the middle of the period, where the relevant work is performed.

Beside indexation, the risk of large price fluctuations is typically the risk of the employer and can be based on (i) increases which happens as a result of central government intervention or (ii) increases due to market changes.

In respect of increases which are due to market changes, there are particular conditions and thresholds, which need to be met. The increase must concern material which, in finished form or in a customary manner, forms part of the works or for fuel directly used for the works. The increase must occur after the tender date and before any indexation takes effect. Furthermore, the increase must be generally occurring, be apparent from official price documents or be capable of being documented in some other

way. Finally, the increase must in aggregate total at least 0.5% of the contract sum, and the price increase for the individual material must be increased by 10% of the price of the relevant material or fuel at the date of tender, with the addition of 0.5 % points for each full month between the date of tender and the date of purchase. Any price increase occurring after the time when the material or fuel was purchased cannot be claimed or compensated.

Where the AB Standards are not used, there are no common rules or practices supporting a possibility to claim indexation or regulation based on price fluctuations.

4.3 Payment

In cases of late or non-payment, the contractor has a number of options.

The contractor is entitled to claim interest in accordance with the agreement or, if nothing has been agreed, the Danish Interest Act.

The contractor is also entitled to stop the construction works if the employer without due cause refuses to pay the amount due by the final date for payment. To be entitled to stop the work, the contractor must first submit a written notice to the employer with a short deadline for payment. The condition thereafter is that the work will be resumed when the payment has been made by the employer. However, stopping the work may include a considerable risk, as the contractor may be liable for the employer's losses if it turns out that the contractor was not entitled to the payment claimed, and on which basis the works were stopped.

Ultimately, the contractor may be entitled to terminate the construction contract if the employer fails to fulfil its key obligation, namely payment

to the contractor. This depends, however, on the circumstances.

4.4 Invoicing

There are no mandatory means of invoicing in Denmark, as this depends on the agreement between the parties. Typically, the parties agree on certain procedures and requirements in respect of invoicing.

Often, the parties agree that the contractor must forward a "draft invoice" to the employer for approval before submitting the actual invoice (to avoid issuing credit notes, etc).

Generally, however, no specific rules on this apply – either by law or in the AB Standards.

5. Time

5.1 Planning and Programme

In accordance with the AB Standards, the tender documents must include a master programme specifying, among other things, the start and end date of the work and interim deadlines, if any. See also 3.4 Construction.

When the construction contract is entered into, the contractor must prepare a working/design schedule and execution schedule that meet the deadlines set out in the agreed master programme.

If it seems likely that the schedules will not be adhered to, they must be updated stating to what extent an extension of time is requested or accepted, and whether the delay concerns a deadline associated with liquidated damages.

Certain milestones are often included in the master programme, and it is not unusual that

Contributed by: Christian Johansen, Liv Helth Lauersen, Christian Taksøe and Christopher Vitoft Ångström, Bruun & Hjejle

if such interim milestones are exceeded by the contractor, this will entitle the employer to claim liquidated damages. The liquidated damages must, however, be specifically agreed and the deadline must have been set to ensure the completion of an activity crucial to the construction process or other material issues.

5.2 Delays

In the event of delays, the party that becomes aware that there will be a delay must notify the other party as soon as possible. Furthermore, the parties must endeavour to avoid or reduce delays by taking such measures as may reasonably be required.

Delays may entitle either the contractor or the employer, or both, to an extension of time (see also **5.4 Extension of Time**). In such cases, the party concerned must notify the other party in writing of the required time extension and the reason for such extension, and the other party must respond to this.

Delays may also entitle the contractor to time-related costs depending on the cause of the delay. If the delay is caused by an event for which the employer is liable, the contractor may be entitled to full compensation for time-related costs. In addition, some events entitle the contractor to an extension of time, but not costs; eg, force majeure events. If the delay is caused by an event for which the employer is not liable, the contractor can, as a general rule, not claim time-related costs.

Concurrent Delay

Concurrent delay occurs when two events, independent of each other, cause delay to a construction project. One event for which the employer is responsible or holds the risk, and

the other for which the contractor is responsible or holds the risk.

True concurrency is rare, and at the same time Danish case law on the subject is sparse. However, the contractor may be awarded an extension of time if a concurrent delay has occurred. Depending on the circumstances, the contractor may also be entitled to compensation.

5.3 Remedies in the Event of Delays

If a contractor is delayed and not entitled to an extension of time, this constitutes an actionable wrong.

In the event of a delay where the contractor is not entitled to an extension of time, the employer is, as a starting point, entitled to claim its losses covered by the contractor.

However, most construction contracts contain an agreement on liquidated damages if the milestone date is exceeded, which is often agreed as a daily penalty fixed as pro mille of the contract sum (usually in the range of 0.5–2%).

If liquidated damages have been agreed, the employer is not entitled to claim additional damages as a result of the delay in question – including where the employer's loss exceeds the liquidated damages. In other words, the liquidated damages replace the employer's right to claim its losses covered by the contractor in the event of the contractor's delay. Conversely, the employer does not have to prove a loss if liquidated damages have been agreed.

As such, there are pros and cons to both types of sanctions (loss covered or liquidated damages).

Contributed by: Christian Johansen, Liv Helth Lauersen, Christian Taksøe and Christopher Vitoft Ångström, Bruun & Hjejle

If the agreement is deemed unreasonable, however, a Danish court or an arbitral tribunal can revise the agreed rate of liquidated damages.

5.4 Extension of Time

In accordance with the AB Standards, the contractor is entitled to an extension of time if the execution of the works is delayed as a result of:

- variations to the works ordered by the employer;
- circumstances relating to the employer or the delay of another contractor;
- events that are not the fault and beyond the control of the contractor (eg, force majeure);
- weather conditions that prevent or delay the work when such weather conditions occur to a significantly greater extent than is usual for the relevant season and region; or
- public enforcement notices or prohibitions that are not due to circumstances relating to the contractor.

The contractor must, as soon as possible, notify the employer in writing of the required time extension and the reason for such extension.

During the assessment of a potential delay, the pivotal points of reference are typically the agreed master programme and the working schedule. A fundamental premise underlying this evaluation is the necessity for an observable impact on the critical path within the project framework before the contractor can legitimately claim entitlement to an extension of time.

5.5 Force Majeure

In the AB Standards, the term “force majeure” covers exceptional external events beyond the control or responsibility of the parties. This would usually include war, riots, acts of terrorism and acts of God.

The term force majeure may differ in Danish construction law, depending on the situation. As such, force majeure is considered to have a wider scope when referring to the contractor’s entitlement to an extension of time compared to when considering the contractor’s risk related to damage to, or loss of, works and materials.

With regard to the contractor’s entitlement to claim extension of time, matters such as fire, strikes, lockouts, blockage and vandalism are usually considered force majeure.

In relation to whether the COVID-19 pandemic itself constitutes force majeure, many variables are at play, and no definitive case law has been published on the subject.

The war in Ukraine may, in and of itself, constitute a force majeure circumstance allowing for easing of obligations if the contract was entered into prior to the outbreak of the war.

In order to receive compensation, which under the AB Standards is generally for time only, several criteria must be met, inter alia that the effect must be unforeseeable, and that the parties must fulfil quite strict duties to mitigate the effects, for instance by seeking out other suppliers, materials, etc.

It is not unusual for the term force majeure to be specifically defined in the construction contract, which may prevent subsequent disputes regarding the interpretation of this term.

5.6 Unforeseen Circumstances

Unforeseen circumstances may qualify as force majeure if the circumstances, as mentioned, are exceptional and beyond the control of the parties. However, if the unforeseen circumstances cannot be qualified as force majeure, the ques-

Contributed by: Christian Johansen, Liv Helth Lauersen, Christian Taksøe and Christopher Vitoft Ångström, Bruun & Hjejle

tion arises as to who is liable for the unforeseen circumstances.

If unforeseen circumstances – despite the performance of preliminary studies as mentioned in 3.5 Site – lead to public enforcement notices or prohibitions that make it impossible or unreasonably burdensome for the employer to continue with the contract, the employer is entitled to cancel the contract with the contractor. In such case, the contractor is entitled to claim its losses covered by the employer (except lost profit related to non-completion of the remaining works).

Such scenarios are, luckily, rarely seen, and the most common result of unforeseen circumstances is that the contractor receives an extension of time and additional payment to overcome the unforeseen obstacles, etc.

5.7 Disruption

Disruption may be acknowledged as a legal ground for extension of time and/or compensation depending on the underlying circumstances of the disruption.

There is no pre-defined exhaustive list of which circumstances may constitute disruption. As such, disruption claims must be assessed on a case-by-case basis. However, the following represent three key causes of disruption:

- the employer's frequent individual changes to the construction project;
- the contractor's missing access to the works and/or construction site; or
- interruptions to the planning of the construction project.

The contractor must prove that the disruptive circumstances have impacted the critical path

and have caused delay to the project if the contractor wishes to claim an extension of time.

The burden of proof lies with the party making a claim, and under Danish law there is generally freedom to consider evidence, meaning that disruption can be proven in several ways. However, typically disruption is proved by the parties' own accounts of what happened or by expert evidence.

Even if the contractor cannot completely prove the disruption, the contractor may still be awarded a discretionary extension of time and/or compensation.

Lastly, if the contractor wishes to claim compensation, the contractor must be able to prove that the losses originate from the disruptive circumstances.

6. Liability

6.1 Exclusion of Liability

As a general rule, liability may be limited by the agreement between the parties within construction contracts. In Danish construction contracts, this mainly finds expression in agreeing to a specific cap for which a party can be liable.

For instance, in ABR 18 (the employer/contractor–consultant standard agreement), the consultant's maximum liability for damages is limited to twice the agreed consultancy fee, but no less than DKK2.5 million – provided that no project liability insurance has been taken out.

However, as an exception to the general rule of freedom of contract, it should be noted that an exclusion of liability may not apply if the party in question has acted with gross negligence or

Contributed by: Christian Johansen, Liv Helth Lauersen, Christian Taksøe and Christopher Vitoft Ångström, Bruun & Højle

wilful misconduct or if the party has materially breached its core obligations.

6.2 Wilful Misconduct and Gross Negligence

Wilful misconduct and gross negligence are known legal concepts in Denmark – also in relation to a construction contract. Besides in relation to a limitation of liability as described in **6.1 Exclusion of Liability**, these terms are also relevant in relation to the AB Standards and, more generally, compensation.

AB Standards

As an example, even if the five-year absolute deadline for submission of a claim related to defects has been exceeded (as described in **3.11 Defects and Defects Liability Period**), the employer's claims for defects that are a result of the contractor acting with gross negligence or wilful misconduct are not limited by this period.

Another example is the employer's relationship to its contractor's subcontractors. As a part of the AB Standards, the employer waives any claim for non-contractual damages against its contractor's subcontractors in respect of matters covered by a direct claim for defects. This, however, does not apply if the direct claim for defects against the subcontractor has been caused by an intentional or grossly negligent act on the part of the subcontractor.

Compensation

Furthermore, negligence is relevant for establishing a basis for liability in relation to compensation. However, in Denmark, ordinary negligence is sufficient to establish this basis of liability.

6.3 Limitation of Liability

As described in **6.1 Exclusion of Liability**, it is – as a clear starting point – possible to limit one's liability.

In Danish construction contracts, this is usually done in the contracts between an employer/contractor and a consultant. Furthermore, a contractor's liability may also be limited to a certain maximum amount.

7. Risk, Insurance and Securities

7.1 Indemnities

Since the AB Standards divide the responsibilities and risks between the parties in a thorough and balanced way, specific indemnity clauses are generally not used to limit risk in relation to construction projects in Denmark.

7.2 Guarantees

In accordance with AB 18 and ABT 18, both the contractor and the employer must provide a performance bond as security for the performance of their obligations. This does not apply to the employer if the employer is a social housing organisation or a public employer.

A performance bond must, unless otherwise agreed, be in the form of an adequate bank guarantee, fidelity insurance or some other adequate type of security. Parent company guarantees do not meet this requirement, but it may be agreed between the parties that such a guarantee is sufficient.

Until handover has taken place, the contractor's performance bond must correspond to 15% of the contract sum exclusive of VAT. After handover, the performance bond is reduced to 10%. The performance bond is further reduced from

Contributed by: Christian Johansen, Liv Helth Lauersen, Christian Taksøe and Christopher Vitoft Ångström, Bruun & Hjejle

10% to 2% one year after handover and ceases altogether five years after handover, unless the employer has submitted a prior written notice of defects. In such a case, the bond is reduced when the defects have been rectified.

The employer's performance bond must correspond to three months' average payments – but not less than 10% – of the contract sum exclusive of VAT. The performance bond will cease once the contractor has submitted the final account and has no outstanding claims.

Both the employer and the contractor can request payment under the performance bond. Such request must be made in writing and notified simultaneously to the other party and the guarantor, specifying the amount claimed. The amount claimed is payable to the contractor within ten working days after receipt of the notification unless the relevant other party has filed a request with the Danish Building and Construction Arbitration Board prior to this, asking the board to issue a decision on the security provided under the performance bond, in particular, with a view to determining whether the payment claim is justified.

7.3 Insurance

Some insurances are mandatory when entering a construction contract and carrying out construction work in Denmark. The insurances must be taken out by either the employer or the contractor.

Insurances Taken Out by the Employer

The employer is obliged to take out and pay for fire and storm insurance according to AB 18 and ABT 18.

Furthermore, in accordance with the Danish Building Act, the employer must take out build-

ing damage insurance if a building is mainly used for residency. This is unless the building is intended to be rented out.

As an optional insurance, the parties can agree on all-risk insurance, which is commonly agreed for large buildings or civil engineering work contracts.

Insurances Taken Out by the Contractor

The contractor is obliged to take out professional and product liability insurance. This is insurance that covers damages to employer's or a third-party's person or property. However, the insurance does not cover damages to objects where the damage is caused during performance of repairs, installing, mounting, or, in other ways, reworks, and where the insured has accepted these works.

7.4 Insolvency

The provisions regarding bankruptcy and insolvency are similar in the various AB Standards and apply if a party is declared bankrupt, subject to reconstruction proceedings or if the party's financial situation in general is such that it must be assumed that the party is unable to perform its obligations under the construction contract.

If one of these scenarios occurs (eg, bankruptcy), the other party is entitled to terminate the construction contract.

Prior to the actual termination, however, the party must give a written notification to the bankruptcy estate, and the estate must determine whether it wishes to become a party to the contract. This follows from the Danish Bankruptcy Act.

It is worth noting that the bankruptcy estate must give notice of this without undue delay, and

Contributed by: Christian Johansen, Liv Helth Lauersen, Christian Taksøe and Christopher Vitoft Ångström, Bruun & Hjejle

the bankruptcy estate will seldom enter into a construction contract.

In the situation where a party is subject to reconstruction proceedings or, due to its financial situation, is assumed to be unable to perform the construction contract, that party may avoid a termination by immediately providing adequate security for the performance of the contract.

7.5 Risk Sharing

In Denmark, there is nothing to prevent the parties from agreeing to share a certain risk. However, such risk sharing is not a common practice in construction contracts.

8. Contract Administration and Claims

8.1 Personnel

In recent years, there has been an increase in so-called labour clauses. Such clauses usually oblige those working on a construction project to ensure that the workers employed receive wages, special allowances and enjoy working conditions that are no less favourable than those established for work of the same character under a collective agreement entered into by most representative organisations of workers and employers in Denmark in the industry concerned.

Such clauses are mandatory when one of the parties is a public entity, but these clauses are becoming more and more common for private entities as well.

8.2 Subcontracting

In accordance with AB Standards, the contractor or consultant may subcontract the execution of the works or the design to subcontractors or

subconsultants if it is customary or natural for the works/design to be executed by a subcontractor.

However, in larger construction contracts, it is often agreed that all or specified parts of the works are to be executed by the contractor or that the employer must pre-approve subcontractors.

8.3 Intellectual Property

Intellectual property is not regulated in the AB Standards. The general starting point according to which the creator has the intellectual property rights therefore still applies. However, the contractor and the employer have a right to use the design materials, descriptions, drawings, etc, made, for example, by the consultant, provided that these are used in an ordinary and intended matter in connection with the construction project.

The employer's right to use such documents (drawings, descriptions and other design material) also applies if the employer has rightfully terminated the contract, if the removal or lack of access to these documents would inflict a loss on the employer.

It is, however, occasionally seen that the parties agree on certain provisions regarding the intellectual property of the design material, etc, prepared in relation to a construction project.

9. Remedies and Damages

9.1 Remedies

The remedy available in the event of a breach of a construction contract depends on the specific circumstances, notably the severity of the breach and what the breach relates to.

Contributed by: Christian Johansen, Liv Helth Lauersen, Christian Taksøe and Christopher Vitoft Ångström, Bruun & Hjejle

With regards to termination, under Danish law, a party is generally entitled to terminate a contract if there is a material breach, and such breach may express itself in many ways, just as it may be agreed beforehand in which situations a party may terminate the contract.

The AB Standards include specific provisions regarding the remedy available in different situations.

For instance, it follows from the AB Standards that an employer is entitled to demand that a subcontractor or supplier is deprived of its right to execute works and deliver materials to the construction project, if that party has failed materially to comply with applicable rules or agreed terms and conditions on social responsibility, including rules on health and safety at work. Thus, the employer has, in certain circumstances, a right to remove a subcontractor from the construction project even though the employer has no contractual relationship to that subcontractor.

Nonetheless, the most frequent scenarios are related to delay and defects, and a few notes on these situations are therefore inserted below.

The Employer's Remedies in Relation to Delay and Defects

The most common remedy available for the employer in the case of a contractor's delay is liquidated damages, as described in **5.3 Remedies in the Event of Delays**.

Furthermore, the employer is entitled to terminate the construction contract in whole or in part with immediate effect in the event of material delay by the contractor.

With regard to defects, which are assessed at the time of handover, the employer is entitled to retain a reasonable amount as security for the rectification of defects notified at the time of handover. This amount is payable to the contractor as soon as possible after the defects have been rectified.

The contractor has both a duty and a right to rectify the defects identified at handover. However, if the contractor fails to rectify the defects within a reasonable time, then the employer is entitled to have the defects rectified at the contractor's expense or to be granted a reduction in the contract sum.

During the project, the employer is further entitled to terminate the contract if the works are executed at such a low-quality level that the employer has reasonable grounds to assume that the contractor will not be able to complete the works without material defects.

The Contractor's Remedies in Relation to Delay

If the employer fails to pay an amount due by the final date for payment, various remedies are available for the contractor. See also **4.3 Payment**.

The contractor may stop work if the employer fails to pay an amount due. Prior written notification with three working days' notice must, however, be submitted to the employer.

The contractor is also entitled to terminate the construction contract in the event of material delay related to the employer or delays by another contractor, provided that the employer does not make reasonable efforts to expedite the works. Other material breaches by the employer

Contributed by: Christian Johansen, Liv Helth Lauersen, Christian Taksøe and Christopher Vitoft Ångström, Bruun & Hjejle

may also entitle the contractor to terminate the contract.

9.2 Restricting Remedies

Provisions containing restriction of remedies are not uncommon in Danish construction contracts, but most commonly the provisions on remedies in the AB Standards are used, though often with certain nuances.

Danish construction law is, however, not as strict in its literal interpretation as other jurisdictions, and parties sometimes attempt to formulate quite one-sided remedy provisions. Significantly one-sided provisions can be challenged and are sometimes set aside by Danish arbitral tribunals.

9.3 Sole Remedy Clauses

Sole remedy clauses where certain types of remedy are strictly excluded, etc, are not common in construction contracts in Denmark.

As described in **5.3 Remedies in the Event of Delays**, liquidated damages are often agreed and entail that the employer is not entitled to claim additional damages related to that delay. This may be considered a sole remedy clause to some extent, but besides such clauses, sole remedy clauses are generally not used. Part of the explanation for this is presumably due to the excluded damages in the AB Standards, see **9.4 Excluded Damages**.

9.4 Excluded Damages

In the AB Standards, certain damages are excluded from liability.

Generally, the contractor is not liable for any loss of business, loss of profit or other indirect losses resulting from defects. In relation to the contractor's product liability, the contractor is likewise not liable for any loss of business, loss

of profit or other indirect losses resulting from damage caused by a defect in a product used in the building or construction works.

Furthermore, in relation to delay caused by the employer, the employer is not liable for lost profits as a result of the contractor being unable to carry out other work in the delay period and similar ensuing losses.

9.5 Retention and Suspension Rights

Under Danish law, a party has a general right to withhold or set off payment against the other party if one has a (counter) claim. Such rights may be amended in the construction contract but are most often not amended.

As such, withholding payment or setting off a claim is a common tool for employers if, for instance, the employer has a claim against the contractor as a result of a breach.

9.6 Termination

Termination of a Construction Contract by the Employer

The employer may rightfully terminate the construction contract under AB 18 or ABT 18, in whole or in part:

- 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

Contributed by: Christian Johansen, Liv Helth Lauersen, Christian Taksøe and Christopher Vitoft Ångström, Bruun & Højle

- if the contractor otherwise commits material breach with regard to matters of decisive importance to the employer.

If the employer rightfully terminates the contract, the employer may be entitled to compensation for additional costs, in so far as the cost of engaging another contractor to complete the project exceeds the original contract sum. Furthermore, the employer may be entitled to a reduction in the contract price if the works already performed are defective.

Termination of a Construction Contract by the Contractor

The contractor may rightfully terminate the construction contract under AB 18 or ABT 18:

- in the event of material delay as a result of the circumstances of the employer or 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 material breach with regard to matters of decisive importance to the contractor.

If the contractor rightfully terminates the contract, the contractor may be entitled to payment for works already performed. In addition, the contractor may claim a loss of profit for the remaining works that the contractor would have been entitled to perform under the (now terminated) contract.

10. Dispute Resolution

10.1 Regular Dispute Resolution

The public courts are generally competent to adjudicate disputes in Denmark, if nothing else is agreed between the parties.

However, since the AB Standards include an arbitration clause and since the AB Standards are used in most larger construction contracts, most construction disputes are subject to resolution under the auspices of the Danish Building and Construction Arbitration Board.

The Danish Building and Construction Arbitration Board presently handles approximately 400 arbitration cases and more than 1,000 requests for expert opinions a year and is therefore highly capable and experienced.

10.2 Alternative Dispute Resolution

As mentioned, arbitration is commonly used within construction disputes if the parties have based their contract on the AB Standards.

In addition to arbitration, the AB Standards include various alternative dispute resolution methods.

Dispute Resolution Ladder

The AB Standards contain a so-called dispute resolution ladder. This entails that efforts must be made to resolve and settle a dispute between the parties through negotiation, at either party's request.

Mediation, conciliation, speedy resolution and arbitration may not be initiated before the negotiation procedure has been completed.

Contributed by: Christian Johansen, Liv Helth Lauersen, Christian Taksøe and Christopher Vitoft Ångström, Bruun & Hjejle

Mediation and Conciliation

Furthermore, at the request of either party, the Danish Building and Construction Arbitration Board will appoint a mediator with the purpose of settling a dispute. The parties have a duty to participate in the mediation/conciliation process, and no arbitral proceedings may be initiated or continued until the mediation/conciliation process has been completed.

Speedy Resolution

In certain cases, the Danish Building and Construction Arbitration Board can appoint a so-called umpire to make a speedy resolution at the request of a party.

Not all disputes are suitable for speedy resolution. A few examples of disputes that are suitable for speedy resolution are:

- the employer's entitlement to withhold payments or set off an amount in the contractor's claims for payment;
- the employer's right to order variations and the contractor's right to execute such variations;
- disputes with a monetary value of less than DKK200,000; and
- other disputes, if agreed by the parties.

Trends and Developments

Contributed by:

Christian Johansen, Liv Helth Lauersen, Christian Taksøe and Christopher Vitoft Ångstrøm

Bruun & Hjejle

Bruun & Hjejle has three very experienced partners in its construction team – Christian Johansen, Liv Helth Lauersen and Signe Direrks Bakkeng– as well as 12 attorneys and eight assistant attorneys. The office is located in Copenhagen, Denmark, but often deals with cross-border disputes, while projects with international scope are handled in co-operation with a network of law firms in other jurisdictions. The construction team, ranked in Chambers Band 1, advises Danish and international clients on legal matters relating to the building and con-

struction sector and its members are legal advisers on many of the largest and most high-profile construction and infrastructure projects in Denmark. The team advises clients on disputes arising during the execution of large and complex construction projects and has extensive litigation experience and knowledge within strategic planning and accommodation of commercial considerations, which are often at play in the handling of disputes during or after the construction phase.

Authors



Christian Johansen has 25 years' experience as a construction lawyer, which includes the drafting of international commercial contracts and acting as counsel

in construction disputes, including international arbitration. Christian's work covers domestic and international construction contracts in the areas of infrastructure, energy, offshore and construction insurance, and he regularly acts in litigation, mediation and arbitration. He became a partner at Bruun & Hjejle in 2012, managing partner in 2023, and is a member of the Chartered Institute of Arbitrators in London. Christian is presently one of only three lawyers in Denmark ranked in Chambers Band 1 within construction. He is also a published author.



Liv Helth Lauersen is a leading profile in construction and contract law and has extensive experience advising domestic and international clients. Liv is consistently engaged to handle

leading court and arbitral cases, adeptly representing owners, contractors and advisers alike. At Bruun & Hjejle, Liv draws upon a solid breadth of knowledge and experience in all stages of the construction process, ranging from initial negotiations of contracts and subcontracts to the performance thereof, along with handling matters of contract interpretation, calls on bonds and guarantees as well as dispute resolution in all its facets.

DENMARK TRENDS AND DEVELOPMENTS

Contributed by: Christian Johansen, Liv Helth Lauersen, Christian Taksøe and Christopher Vitoft Ångstrøm, Bruun & Hjejle



Christian Taksøe is an experienced lawyer specialised in construction law and dispute resolution in general. He advises domestic and international clients on matters related to

construction law and in all stages of the construction process, including tender and negotiation of contracts, contract and project management, insurance-related matters, call on guarantees, and the handling of disputes. Christian is renowned for his work on large and complex construction and infrastructure projects. He acts as counsel in arbitration and litigation and is involved in several leading cases. Christian started at Bruun & Hjejle in 2013 and has in an interim period worked as an assistant judge at the Danish Supreme Court.



Christopher Vitoft Ångstrøm is a rising profile within construction, infrastructure, and offshore projects. He particularly focuses on, and has experience with, advising on large-scale

projects, domestically and internationally. Christopher acts as counsel on projects from the initial contract negotiations and through the ongoing contract management, where he advises on the Danish AB-suite of contracts, the FIDIC suite of contracts, Orgalime, and bespoke contracts. Christopher regularly acts as counsel in arbitrations both during and following projects. He started at Bruun & Hjejle in 2016 but has had interim experience as an in-house attorney working on major renewable energy projects within EU, US, and APAC.

Bruun & Hjejle

Nørregade 21
1165 Copenhagen K
Denmark

Tel: +45 33 345 000
Email: chj@bruunhjejle.dk
Web: www.bruunhjejle.dk

BRUUN & HJEJLE

Contributed by: Christian Johansen, Liv Helth Lauersen, Christian Taksøe and Christopher Vitoft Ångström, Bruun & Hjejle

Sustainability

The use of recycled building materials

On 1 January 2023, climate requirements were added to the Danish Building Regulations, meaning that all new buildings must be accompanied by a Life Cycle Assessment (LCA). An LCA is a methodology for evaluating the environmental impact of a building over a period of time. Additionally, new heated buildings with an area of more than 1,000 square metres must adhere to a predefined threshold limit value of 12 kg CO₂ equivalents per square metre per year.

The initial wording of these climate requirements failed to consider the reduced climate impact resulting from the use of reused building materials. The climate requirements from 1 January 2023 dictated that if reused building materials were used in a new building, they would be treated exactly like new construction materials in respect of their climate impact. This approach did not encourage the use of reused building materials and led to confusion among sector participants, as the then-new climate requirements clashed with sustainability.

Effective 1 January 2024, changes were made to the climate requirements in the Danish Building Regulations whereby the use of reused building materials in new buildings will not affect the LCA as they are assigned a factor of “0” in LCA calculations. This will undoubtedly create a further incentive to make use of reused building materials. This incentive is likely to increase over time, as the threshold limit value is set to be progressively lowered over the coming years, which will require even more sustainable and innovative approaches to meet the threshold limit value.

Still, this new initiative is not without its challenges. It prompts considerations and discussions about the suitability and quality of reused

building materials, as in Denmark, it is a common rule that construction materials must be of “customary good quality” – unless otherwise agreed. Accordingly, the report to the AB System implies that reused building materials may not generally meet the standard of “customary good quality”. It is possible that this premise will be modified over time, particularly regarding certain materials, such as bricks.

To avoid yet another clash – this time with quality requirements – the construction sector needs to align on forming requirements, which balance climate requirements, sustainability, and quality requirements. Likely, a common set of rules and agreed guidance, for example as an additional appendix to the Danish AB form of contracts, embracing the wide range of requirements needed in the coming years, could be of great value to the sector.

In the interim period, the parties must ensure the establishment of supplementary agreement provisions pertaining to this issue.

New EU legislation on energy performance in new and renovated buildings

In December 2023, the EU legislature reached a provisional agreement on the revision of the Energy Performance of Buildings Directive (EPBD), which will undergo the formal approval process during 2024. To ensure buildings align with the EU’s ambitious climate goals under the European Green Deal, the revised Directive will establish new and more ambitious requirements for energy performance in new and renovated buildings in the EU, and it encourages member states to renovate their building stock. The primary aim of the revision is for all new buildings to be zero-emission buildings by 2030 and for existing building stock to be converted to zero-emission buildings by 2050.

Contributed by: Christian Johansen, Liv Helth Lauersen, Christian Taksøe and Christopher Vitoft Ångström, Bruun & Hjejle

Among other measures, the Directive will introduce minimum energy performance standards for non-residential buildings along with new renovation targets for residential properties, which will contribute to a reduction in average energy consumption. Additionally, the Directive aims to develop a harmonised model for energy certification schemes in the EU by 2025.

Local initiatives

In Denmark, it is a political goal to achieve a 70% reduction in the CO₂ footprint by 2030, and significant progress has already been made since 1990. However, when focusing on resource consumption and biodiversity within the Danish construction sector, significant potential for improvement remains. Based on this premise, combined with the increasing pressure for a sustainable future, a broad partnership across companies and organisations within the Danish construction sector has established a “Construction Action Tank for Sustainability”. The Action Tank aims to outline a strategic direction for the sector, as well as to developing concrete recommendations and solutions for a sustainable development of the Danish construction sector.

In January 2024, the Action Tank published a report with recommendations for the green transition of the Danish construction sector. The comprehensive report consists of 33 different action-oriented recommendations distributed across three general ambitions: combating climate change, transitioning to a circular economy, and protecting and restoring biodiversity and ecosystems.

One of the recommendations is to introduce stricter conditions for demolition, in order to support renovation and transformation of existing buildings. Another interesting recommendation from the report concerns the development of a

common national tool for mapping biodiversity on-site in relation to construction projects.

The purpose of the Action Tank is to prioritise specific initiatives from the report, aimed at ensuring the implementation of the recommendations and thus turning words into action.

The Dispute Landscape in the Danish Construction Sector – Increasing Complexity and Major Sums at Stake

Over the recent decades, it has been evident that construction projects are becoming still larger and more complex. Old solutions are continuously improved upon and new technologies emerge constantly. At the same time, a greater focus has been given to financing, economy, and timely finalisation, while more rules and regulations are simultaneously introduced to the construction sector. In addition, Russia’s ongoing war against Ukraine, the impact of inflation on raw materials and the aftermath of COVID-19, is still pressuring the stakeholders in the construction sector.

Perhaps unsurprisingly, disputes in the sector have also increased in both scale and complexity.

In Denmark, most major construction projects are based on the AB form of contracts, which are a set of agreed documents. The dispute resolution mechanism in the AB system provides for the possibility of both a so-called “speedy resolution” and ordinary arbitration. Both speedy resolution and arbitration are subject to the Danish Building and Construction Arbitration Board as venue for the parties.

While arbitration has always been an option in the AB system, speedy resolution was intro-

Contributed by: Christian Johansen, Liv Helth Lauersen, Christian Taksøe and Christopher Vitoft Ångström, Bruun & Hjejle

duced with the new 2018 versions of the AB form of contracts.

In the period 2019–2023, the number of arbitration disputes brought before the Danish Building and Construction Arbitration Board declined almost 30%, from 354 disputes in 2019 to 254 disputes in 2023. The number of disputes initiated as speedy resolutions increased by 50% from 46 in 2022 to 69 in 2023, suggesting that stakeholders are still warming up to the use of speedy resolution as a dispute resolution method.

While the development in arbitration is positive, based solely on the number of disputes, the value of construction disputes has increased. In 2021, the Danish Building and Construction Arbitration Board reported that of a total of 296 arbitration disputes, 46% related to an amount between DKK1–10 million, 19% related to an amount between DKK10–50 million and 7% related to an amount above DKK50 million. Thus, 26% of all disputes in 2021 related to amounts above DKK10 million. This is a stark increase compared to 2014, when only 10% of all disputes related to amounts above DKK10 million.

It is our expectation that these trends will continue going forward.

In addition, there has been a substantial increase in the number of decisions made by arbitrators and the Danish Building and Construction Arbitration Board relating to various procedural matters. This may be due to the increased value of disputes, making each “battle” seemingly more important. However, it may also be due to uncertainty within legal areas specific to the Danish construction sector, namely disputes involving expert appraisals of technical matters.

On 25 January 2024, the Danish Building and Construction Arbitration Board published a “practice memorandum” comprising essential decisions relating to procedural matters in connection with expert appraisals. On 19 March 2024, a similar memorandum was published related to speedy resolutions, further assisting in establishing speedy resolutions as a viable method of dispute resolution. Both memoranda have shed more light on the practice of the Danish Building and Construction Arbitration Board and have been well received by the sector.

The purpose of the memoranda is to ensure or create consistency in application of the procedural rules on these matters. Potentially, this may also have a positive effect on the number of decisions needed to resolve disputes related to procedural matters.

LEG3 Insurance Coverage Under Scrutiny

Construction contractors are regularly faced with costly damages resulting from defects in materials, workmanship and design. The substantial market demand for insurance coverage relating to defects has prompted insurers to offer various standard clauses, including the three “LEG” clauses developed by the London Engineering Group. Each LEG clause offers different levels of coverage for damages resulting from defective material, workmanship and design, with LEG3 offering the most comprehensive protection of policyholders. LEG3 is intended to provide extensive coverage, only exempting costs incurred to improve the original material, workmanship or design. Such costs are, thus, to be maintained with the party responsible for the material, workmanship or design. Despite LEG3 being widely adopted internationally in the construction insurance market, the exact interpretation of the clause has been a persistent source of uncertainty.

Contributed by: Christian Johansen, Liv Helth Lauersen, Christian Taksøe and Christopher Vitoft Ångström, Bruun & Hjejle

Numerous large construction projects in Denmark are currently covered by all-risks insurance policies that include a LEG3 clause, and the meaning of LEG3 is also the subject of several disputes.

Although LEG3 has been in the market for over 25 years, there has been a notable scarcity of published court rulings or arbitral awards worldwide on the clause to help provide clarity on the legal positions for both policyholders and insurers. The limited legal precedent is a consequence of the prevalence of arbitration clauses in most commercial insurance policies, resulting in disputes being resolved through private arbitration rather than in public court proceedings. Specifically in Denmark, case law in respect of LEG3 is close to non-existent.

Recently, two American court decisions – *South Capitol Bridgebuilders v Lexington Insurance Co* and *Archer Western De Moya JV v Ace American Insurance Co* – have considered the LEG3 clause with positive outcomes for policyholders. Both cases centred on insurance coverage for damages arising from defective workmanship. Points of contention included whether the insured property was merely defective or also damaged, and what constitutes costs incurred to “improve”, which LEG3 excludes from coverage. Both courts held that the wording of LEG3 is ambiguous, which is notable considering the widespread use of LEG3 over its more than 25 years’ lifespan. Ultimately, the courts ruled in favour of the policyholders and dismissed arguments from the insurers that insured property must have been in an initial satisfactory condition to be capable of sustaining damage. This indicates that defects may also, to some extent, be covered by insurance, which has been the subject of considerable disputes.

Now, LEG3 is also to be tested in the Danish courts. Several contractors in Denmark are covered by LEG3 on various projects; one of them is currently engaged in the first Danish court case concerning LEG3, which is scheduled to be heard in the High Court next year.

NIS2 and CER Directive

The EU agenda on cybersecurity and resilience

The EU agenda reflects an increased awareness of the risks stemming from both digital and physical threats; a development particularly underscored by the enactment of the two Directives, “NIS2” and “CER”, relating to cybersecurity and physical resilience, respectively.

The Directives cover critical entities in eleven sectors, including energy, transport and health, which provide essential services in upholding key functions, supporting the economy, ensuring public health and safety, and preserving the environment.

The facilities of these entities are often considered “critical infrastructure”, and sufficient security measures and mechanisms need to be in place to protect against physical and digital attacks. Recent attacks on critical infrastructure, for example the Nord Stream 2 pipeline, highlight the importance thereof.

The NIS2 and CER Directives are designed to establish a high common level of security measures across the Union for both public and private enterprises and provide a robust framework for building collective protection against various threats.

In Denmark, the Directives will be implemented by the enactment of two bills encompassing a range of various sectors, including the construc-

Contributed by: Christian Johansen, Liv Helth Lauersen, Christian Taksøe and Christopher Vitoft Ångström, Bruun & Hjejle

tion sector. The acts are expected to enter into force on 1 January 2025.

The Danish legislation is expected to be drafted in accordance with the principles of “minimum implementation”, closely mirroring the requirements in the Directives. Accordingly, most stakeholders in the Danish construction sector will not be subject to more burdensome requirements than other EU member states. However, the energy sector will not be subject to the main NIS2 and CER legislation; rather, implementation will take place through specialised legislation by the Ministry of Climate, Energy and Utilities, which is expected to impose stricter requirements on these sectors, thereby highlighting their position as “critical infrastructure”.

Below, a high-level overview of the NIS2 and CER Directives is provided from a Danish law context.

NIS2 Directive

The NIS2 Directive is designed to cover a larger portion of companies in the energy, health and transport sectors than the previous Directive, NIS1. In contrast to the NIS1 Directive, the NIS2 Directive obligates the companies directly covered by the bill to impose compliance with the Directives’ security measures on their contractual partners. This is a departure from the norm in Denmark, where the tradition is to leave the actual execution to the implementers, without intercontractual oversight thereof.

NIS2 entails multiple requirements concerning risk management, mandating companies to implement “appropriate security measures”, such as policies on risk analysis and information system security, incident handling and supply chain security. According to NIS2 Article 21 (2) the measures must be based on an all-hazard

approach that aims to protect network and information systems, and the physical environment, including server rooms, data centres, network equipment and other installation sites where networks and information system operate. Thus, adherence to the obligation during the preliminary and detailed design stages of the construction process is of paramount importance.

CER Directive

The implementation of the CER Directive is designed to strengthen the resilience of critical entities, enhancing their capacity to mitigate risks which may otherwise disrupt the delivery of essential services. The Directive mandates the encompassed companies to carry out risk assessments in view of their circumstances. In relation thereto, the companies must continually consider the evolution of all risks that could disrupt the provision of their essential services. As a minimum requirement, a risk assessment must be performed every four years.

According to CER Article 13 (1)(b) the measures should be necessary to ensure adequate physical protection of their premises and critical infrastructure, duly considering, for example, fencing, barriers, perimeter monitoring tools and routines, detection equipment and access controls. It is therefore important that the entities keep this in mind during the preliminary and detailed design stages of the construction process.

For both the NIS2 and the CER Directives, the regulations will, in practice, entail a need for companies to identify the specific threat-landscape within the context of the company’s overall circumstances, ensuring that appropriate and required measures are initiated effectively.

Contributed by: Christian Johansen, Liv Helth Lauersen, Christian Taksøe and Christopher Vitoft Ångstrøm, Bruun & Hjejle

If companies fail to comply with the Directives, significant sanctions will apply, serving as a clear signal that parties must take security seriously.

As mentioned, the Directives are not expected to be implemented in Denmark until 1 January 2025. The development in terms of how the requirements evolve, and how the practical implementation and management unfold, should, therefore, be closely monitored especially in terms of the construction process.

FINLAND

Law and Practice

Contributed by:

Rosa Lång and Juho Lönnblad
Lieke Attorneys Ltd



Contents

1. General p.242

- 1.1 Governing Law p.242
- 1.2 Standard Contracts p.242

2. Parties p.243

- 2.1 The Employer p.243
- 2.2 The Contractor p.243
- 2.3 The Subcontractors p.243
- 2.4 The Financiers p.244
- 2.5 The Designer p.244

3. Works p.244

- 3.1 Scope p.244
- 3.2 Variations p.244
- 3.3 Design p.245
- 3.4 Construction p.245
- 3.5 Site p.246
- 3.6 Permits p.246
- 3.7 Maintenance p.247
- 3.8 Other Functions p.247
- 3.9 Tests p.247
- 3.10 Completion, Takeover and Delivery p.247
- 3.11 Defects and Defects Liability Period p.248

4. Price p.248

- 4.1 Contract Price p.248
- 4.2 Indexation p.248
- 4.3 Payment p.249
- 4.4 Invoicing p.249

5. Time p.250

- 5.1 Planning and Programme p.250
- 5.2 Delays p.250
- 5.3 Remedies in the Event of Delays p.250
- 5.4 Extension of Time p.250
- 5.5 Force Majeure p.251
- 5.6 Unforeseen Circumstances p.251
- 5.7 Disruption p.252

6. Liability p.252

- 6.1 Exclusion of Liability p.252
- 6.2 Wilful Misconduct and Gross Negligence p.252
- 6.3 Limitation of Liability p.252

7. Risk, Insurance and Securities p.252

- 7.1 Indemnities p.252
- 7.2 Guarantees p.253
- 7.3 Insurance p.253
- 7.4 Insolvency p.254
- 7.5 Risk Sharing p.254

8. Contract Administration and Claims p.254

- 8.1 Personnel p.254
- 8.2 Subcontracting p.255
- 8.3 Intellectual Property p.256

9. Remedies and Damages p.256

- 9.1 Remedies p.256
- 9.2 Restricting Remedies p.257
- 9.3 Sole Remedy Clauses p.257
- 9.4 Excluded Damages p.257
- 9.5 Retention and Suspension Rights p.257
- 9.6 Termination p.258

10. Dispute Resolution p.258

- 10.1 Regular Dispute Resolution p.258
- 10.2 Alternative Dispute Resolution p.258

Lieke Attorneys Ltd is a law firm with a focus on energy and infrastructure, construction, public sector and dispute resolution. Lieke's Real Estate and Construction team has vast experience in real estate and construction-related contract law, project management and dispute resolution. The team advises clients in notable energy and industry development projects as well as complex construction projects of private and public sector clients. The team is ex-

perienced in public procurement issues in the construction sector and has further experience in zoning, permitting and environmental topics. Lieke's Construction team operates closely with its Energy and Infrastructure, Public Procurement and Dispute Resolution practices. This approach minimises risk in construction projects, avoids disputes and improves the competitiveness of its clients. The team comprises three partners and eleven other experts.

Authors



Rosa Lång is a partner, attorney-at-law at Lieke and specialises in construction law, project management and commercial contracts. Lång also advises Lieke's clients on

employment law issues. She is an experienced negotiator both in the contract negotiation phase and in dispute resolution situations. In addition to domestic assignments, she has experience in numerous international projects. Lång has worked for several years in an international construction group as legal counsel for the Nordic and Baltic companies of the group. She has also worked in compliance and GDPR functions, as well as in risk management.



Juho Lönnblad is a partner, attorney-at-law at Lieke and is a well-respected professional in the real estate and construction industry and in legal project risk management. Lönnblad focuses

on construction and real estate projects, with a particular emphasis on providing clients with comprehensive legal and strategic advice and legal risk management services during projects. He also has solid experience in resolving real estate and construction-related conflicts by negotiations, ADR, arbitration and public court procedures.

Lieke Attorneys Ltd

Aleksanterinkatu 11
(entrance Kluuvikatu 6 A)
00100
Helsinki
Finland

Tel: +358 50 573 5373
Email: attorneys@lieke.com
Web: www.lieke.com/en

LIEKE

1. General

1.1 Governing Law

The Land Use and Building Act (132/1999) is the primary piece of legislation regulating construction, land use and planning in Finland.

Several subordinated regulations and decrees regulate in more detail – eg, the technical requirements of buildings.

These regulations are issued by the government and relevant ministries pursuant to the Land Use and Building Act.

In addition, certain matters, such as energy efficiency and requirements for construction materials, are regulated in separate laws.

There is no law specifically governing construction contracts, but the Finnish Contract Act (228/1929) governs all types of contracts and is also applicable to construction agreements.

Note: [The Land Use and Building Act](#) will be renewed and the reformed act will come into force on 1 January 2025.

1.2 Standard Contracts

Use of standard contracts is not mandatory. However, they are generally widely applied throughout the contract chains in construction projects in Finland. Some of the terms are already dated and do not fully take some factors into account – eg, digitalisation. Currently, deviations from the standard agreements are agreed widely between different parties throughout the subcontracting chains to reflect – eg, division of design and project management responsibilities between the parties in different forms of construction projects.

Standard contracts include YSE 1998 General Conditions for Building Contracts, KSE 2013 General Conditions for Consulting and RYHT 2000 General Procurement and Delivery Terms for Construction Products. In larger and more complex construction projects and especially in the field of infrastructure, the FIDIC (International Federation of Consulting Engineers) terms may also be used.

YSE 1998

These terms are widely used between employer/contractor and contractor/subcontractor for construction works contracts.

KSE 2013

These terms are commonly used between client/consultant for design and consulting services.

RYHT 2000

These terms are widely used between buyer/supplier for construction materials procurement throughout the construction chain.

FIDIC: Employer/Contractor/Engineer

These terms are widely in use in the employer-contractor relationship. The type of FIDIC contract depends on the scope and risk allocation. Some of the most used terms are:

- Red Book – the employer is responsible for the design, the contractor for the construction work;
- Silver Book – the contractor bears total liability for the design and project (EPC and turnkey); and
- Yellow Book – the contractor is responsible for the design and execution of works.

2. Parties

2.1 The Employer

In Finland, the companies that act as an employer in a construction project are typically developer/constructor companies, or sometimes project companies or real estate companies established for the purpose of the project. A significant portion of the employers are also public organisations or entities.

It should be noted that in Finland the risk allocation and general rights and obligations depend heavily on the chosen type of construction project. Parties can agree freely on the division of responsibilities under the contract. However, the most common contract types are:

- project management contracting;
- alliance;
- total works contract; and
- turnkey contract.

2.2 The Contractor

In Finland, companies that act as a contractor in a construction project are typically construction companies. Contractors are always responsible for the construction works and procurement of all related construction materials, but depending on the contract type, they may also have responsibilities for design and/or construction management. Usually, the employer arranges the finance for the project but sometimes, especially related to residential building projects, the contractor may also act as the developer of the project. In this case the contractor also arranges the finance. Usually, the contractor co-ordinates the subcontractors and side contractors, and reports to the employer.

2.3 The Subcontractors

Subcontractors are usually smaller companies specialised in a specific field of construction such as electricity, civil works, HVCA and earthmoving.

According to YSE 1998 terms, the contractor needs to inform the employer of any subcontractors used in the project and the employer may refuse the use of a specific subcontractor for due cause. The contractor always carries total liability for the subcontractors' work towards the employer.

The co-ordination obligation of subcontractors' work on site is usually carried out by the contractor. However, the division of responsibilities between different subcontractors is set out in the project agreement documents.

2.4 The Financiers

In Finland, it is common that a specific real estate company is established for the construction project. The real estate company then acts as the employer of the project. Typically, investment management companies and funds act as financiers of the established real estate company, thereby indirectly financing the construction project. In addition, sometimes the construction company carries out the project based on so-called founder contracting, where the construction contractor acts as the property developer and the financing of the construction is at least partly covered by selling the building premises in parallel with the construction works.

2.5 The Designer

Please also see 3.3 **Design**. The type of company chosen to act as designer in a construction project is largely determined by the type of construction project. The largest construction companies can provide all the services required for a construction contract, including building design, on a turnkey basis. However, in most cases, they use design and architecture offices as subcontractors, or the planning/design is procured separately. Architects are in charge of design and planning, and they work hand-in-hand with other designers such as structural, civil and HVAC engineers.

The responsibilities and relationships between the designer, the employer and the contractor vary entirely depending on the type of construction contract and the type of construction project.

KSE 2013 terms are widely used in construction consultation and design agreements. These terms define the obligations and liabilities between the consultant and the client (usually contractor) and the basis for charging, as well

as IPR issues. As for the IPR, the client may not utilise the materials delivered by the consultant for an object or purpose other than the one specified in the contract without the consultant's consent, unless otherwise agreed. The client is, however, entitled to any invention created during research or development efforts in the course of the agreed assignment. The consultant is entitled to additional compensation if the client's right to the invention proves to be substantially more valuable than the compensation paid to the consultant.

3. Works

3.1 Scope

The scope of each party is defined in the main construction contract and other contract documents attached to the contract, which include usually – eg, the building contract programme, building contract requirements, protocol for the contract negotiations, the division of responsibilities table, invitation to tender by the employer, tender documents by the contractor, specifications, designs, safety rules and safety programme, etc.

3.2 Variations

YSE 1998 terms stipulate a procedure to manage any changes to the agreed scope due to modifications in building plans occurring during the construction phase. These variations are divided into modification works and additional works. A modification work may be a change, increase or reduction of works, whereas the additional works are works that did not originally form part of the obligations agreed under the contract. The pricing of the variations to the agreed scope is usually agreed in the agreement – eg, by setting out a unit price list that will apply in case of any agreed change orders during the project.

As a main rule, the contractor is obliged to carry out any modification works requested by the employer. The only exception is when the requested modification would significantly alter the nature of the scope agreed in the building contract. On the other hand, the contractor is also entitled to increase the contract price in the event there is an increase to the agreed obligations due to a modification in the building plans. The contractor has an obligation to notify the employer of any modifications in advance and, as a general rule, no modification work may be commenced before the parties have agreed on the effects of the modification works to the project schedule and contract price. The parties shall agree also on the time-related costs due to the modification works in the change order in accordance with the agreed change management procedure.

3.3 Design

The responsibilities related to the design process depend on the contract between the parties and the type of construction project. In Finland, parties may agree freely on the division of obligations and the allocation of risk. However, the responsibility for design is usually determined by choosing the type of construction project. In Finland, there are standard contract templates published by the Confederation of Finnish Construction Industries RT for different project types. These templates can be freely modified by the parties, but they form a base for the risk allocation, when used.

In a divided multi-party construction work project and all-in works contract, the liability for design lies with the employer. In design-build contracts and turnkey contracts, the contractor is the party responsible for the design, and in project management contracting the responsibilities can be agreed to be carried by either party.

3.4 Construction

The division of responsibilities regarding the construction process may be agreed in several ways, but usually after the design phase, the allocation of responsibilities is as follows.

Responsibilities of the Employer

The employer is responsible – eg, for the following:

- seeking and/or assisting the contractor with arranging all the required permissions and approvals;
- providing the contractor with all necessary information, reports and/or surveys related to the construction site and the project in general;
- arranging of meetings between the employer and the contractor;
- participating in the handover inspection;
- paying the contract price per agreed milestones;
- notifying the contractor of any new information or change in circumstances related to the project;
- reviewing the change orders in a timely manner; and
- providing the contractor with all required approvals in due time.

Responsibilities of the Contractor

The contractor is responsible for all the work carried out by the contractor or any subcontractor within the agreed scope. The contractor shall further ensure that the construction works are performed in accordance with the agreement documents, such as designs and specifications, and that they meet the requirements of construction regulations and are of good professional practice and industry standard.

In addition, the contractor is responsible for the co-ordination of the works of different subcontractors on site and schedule planning and management during the whole project.

Further Obligations of the Contractor

Unless agreed otherwise, the following obligations concerning the work of the contractor also apply to every contractor and subcontractor:

- acquisition of necessary permits for the works carried out by the contractor;
- acquisition of the construction equipment needed for the works;
- carrying out the measurements needed for the building contract;
- drawing up a schedule for the contractor's own works;
- protection of the environment from damage and dirt caused by the works;
- grading and removal of waste generated due to the works and keeping the site tidy by cleaning it up as the work progresses and handing it over to the next-stage contractor or the employer in a tidied and cleared state after the contractor's work is completed;
- building and dismantling the roads and other structures necessary for completing the works;
- submission of the plans and drawings that need to be provided by the contractor; and
- submission of operating and maintenance instructions.

In addition, there are other obligations to be met by the contractors, which are indicated in the contract documents.

3.5 Site

The responsible party for ensuring the condition of the soil of the planned site is the owner or the possessor of the real estate – ie, the employer. By

mandatory law, Finland has a principle according to which the party that has caused pollution shall bear the liability thereof. However, secondary liability lies with the owner of the property.

The employer shall carry out all the relevant surveys and studies related to, inter alia, pollution, underground obstacles and geotechnical conditions on the site and further provide any reports and findings as part of the tender request documentation.

The contractor has an obligation to review all the reports and findings related to the construction site and further inspect the site before commencing the works. In the event the contractor identifies a reason due to which carrying out the construction works according to the planning is not possible, the contractor has an obligation to notify the employer of the matter without delay.

During the construction phase, the contractor is usually responsible for ensuring that the construction site meets the regulatory requirements (eg, regarding safety) set out for construction projects. The building inspection authorities can close down the construction site in the event the site does not meet the regulatory requirements.

3.6 Permits

According to Finnish law, almost all construction projects require a building permit that is granted by the regional building supervision authority. Application for the permit must be filed before the construction commences and the process is typically carried out by the employer. The requirement for other permits depends largely on the location and type of the construction project.

Under YSE 1998 terms, unless otherwise agreed, each contractor carries the obligation for obtain-

ing the permits required for the works under their scope.

3.7 Maintenance

During the construction phase before the handover, it is the contractor who is responsible for maintenance of the works. This is due to the fact that it is the contractor who bears the risk of damage or loss related to the works and materials during the construction phase.

After the handover of the project, the maintenance obligation transfers to the employer. Also, in the event the employer takes part of the works into use before the handover, the maintenance obligation and the risk of loss or damage related to such part lies thereafter with the employer.

3.8 Other Functions

Other functions of the construction process, such as operation, transfer or finance, are typically not instructed by the employer to the contractor or other third parties, but there are exceptions in relation to specific project types.

3.9 Tests

When the construction works are completed and the works are ready for the handover, the contractor needs to first pre-inspect the quality of the work that it is under obligation to carry out, and correct any deficiencies and defects detected. After the contractor's pre-inspection, the works can be inspected by both parties in the handover inspection.

Inspection of construction goods and building components must be carried out on site before they are taken into use, and continuously during the work. Operational inspections of systems and installations shall be carried out in the form of performance tests before taking into use or, at the latest, in connection with the handover

inspection when the system is ready and functioning. The contractor shall bear the costs of customary tests of construction goods and building components and for ascertaining the quality of works.

Qualified supervisors appointed by the employer monitor and supervise the works continuously. The supervisors and the employer have a right to inspect the site and the works any time and to carry out tests that they deem necessary. It is important to note that these inspections do not diminish the contractor's liability and responsibility for the works.

3.10 Completion, Takeover and Delivery

Both the employer and the contractor have a right to request the handover inspection when the works are at a stage where any work still in progress can be completed before the handover inspection takes place.

Before the handover inspection, the contractor needs to pre-inspect the quality of its works and that the works meet the requirements stated in the contract, and in case any defects are detected, correct such deficiencies and defects before the actual handover inspection takes place.

In the handover inspection it is assessed whether the finished result of the construction works fulfil the criteria stated in the contract. Minor finishing works yet to be completed do not prevent the handover in the event they will not cause impediment or harm when the works are taken into use.

In the handover inspection the employer prepares a protocol, in which it is stated whether any agreed obligations have been left unfulfilled and if the works are approved for handover. In

addition, the parties agree a schedule for the minor finishing works to be carried out.

3.11 Defects and Defects Liability Period

After the handover of the works, the contractor has a liability for any defects for a guarantee period of two years unless otherwise specified in the contract. During this time, any detected deviation from the contract requirements must be repaired or replaced by the contractor. The contractor's work covered by the guarantee also includes additional and modification work.

During the guarantee period, the contractor is obliged to repair all defects, which the contractor cannot establish to have occurred for reasons beyond its control, for example by showing that the defect is due to normal wear and tear, or caused by incorrect use or neglect of maintenance measures for which the employer is liable.

Defects that create impediment for using the works or cause danger or disrepair must be repaired or removed by the contractor without delay. If the contractor fails in carrying out the repairs, the employer shall be entitled to carry out the work at the expense of the contractor after the employer has given prior notice of this to the contractor in writing.

If the defect is such that its correction is not necessary for the use of the building, and the cost of the repair would be unreasonable, the contractor, instead of repair or replacement, is obliged to reimburse the loss in value to the employer.

To secure its rights, the employer shall notify the contractor within a reasonable time after the defects were discovered or should have been discovered. If the employer fails to notify the contractor within a reasonable time, it may lose its right to claim the rectification of defects.

Even after the two-year guarantee period, the contractor is liable for any defects that the employer could reasonably not have noticed during the handover inspection or during the guarantee period, and that are due to gross negligence, work left uncompleted or a material failure of contractor's quality assurance process. The contractor is released from this liability after ten years have elapsed from the handover inspection.

4. Price

4.1 Contract Price

In Finland, the price may be agreed as a fixed price or as time- and material-based, or a combination of these two. The methods to establish the price can be agreed freely between the parties. However, the most common way to establish the price is to agree on a fixed price with a milestone payment plan.

The price usually includes all the construction materials and work necessary for carrying out the agreed scope. The scope, which needs to be covered by the price, is presented in the employer's invitation to tender documents, based on which the contractor will calculate the price to its tender.

4.2 Indexation

Finnish legislation and the YSE 1998 and RYHT 2000 commonly in construction contracts allow the contract price to be indexed, but this has been historically relatively limited. There has been a trend in the recent years to start to use indexation clauses, especially in large projects, where the duration of the construction phase is long, but still this is considered on a case-by-case basis and a major part of the projects are price fixed. If indexation is not explicitly agreed

in the contract, general cost increases do not affect the price. Thus, if there is no indexation clause in the contract, the contractor alone bears the risk of rising costs and ultimately the profitability of the contract. On the other hand, the owner of a building project doesn't benefit from a fall in prices.

According to the freedom of contract, the parties can agree on how to link the price to the index, but YSE gives an option where the agreed price is paid as usual and revised when the index point value is published. In most cases, the contract price is linked to the Building Cost Index published and revised monthly by Statistics Finland. The aforementioned templates (YSE and RYHT, for example), can be freely modified by the parties, but they form a base for the risk allocation when used. All in all, the parties are free to agree on risk allocation in the contract as they deem fit.

4.3 Payment

The parties can agree the payment term and the delayed interest rate in their agreement.

Unless agreed otherwise, the contractor may claim delayed interest stipulated under the Interest Act, if the employer does not fulfil its payment obligations within 14 days from a legitimate invoice.

In addition, the contractor has a right to terminate the agreement in the event of non-payment, provided that the contractor has notified the employer of the termination threat in writing and has given the employer a reasonable time to correct the non-payment. Instead of terminating the agreement, the contractor may also interrupt the works temporarily until the payment obligation is fulfilled.

It should be noted that the employer may have a withholding right related to the contract price not yet paid – eg, in the event of delay or defect on the contractor's side.

4.4 Invoicing

The parties can agree on the invoicing in the construction agreement.

Unless otherwise agreed, the invoices must be paid when the invoice is presented to the employer and the corresponding work stage under the contract is found to be completed or the invoice has otherwise been accepted to be due for payment. If the contract does not include a payment schedule or other provision on the arrangements for payment, the employer must pay the contract price to the contractor in the form of instalments, where the part payment to be paid is in proportion to the works carried out.

The final instalment of the contract price must be paid on the date defined in the payment schedule. Unless defined otherwise in the payment schedule or the contract, the final instalment must be paid after the handover, but at the latest after the final settlement of the accounts is completed, or when the financial relationship of the contracting parties has otherwise been settled.

An increase in the contract price or, correspondingly, a reimbursement, on account of additional or modification work, must be paid to the contracting party once the modification or additional work is completed. In the case of fairly extensive modification or additional work, the parties may agree on paying the compensation in several instalments as the work progresses.

5. Time

5.1 Planning and Programme

The employer prepares a high-level main schedule for the different phases of the construction project, which guides the more detailed planning of different project phases (design and planning phase, procurement phase and execution phase).

Unless otherwise agreed, the employer will also prepare the project/design schedule together with the contractor.

Unless otherwise agreed, the contractor is responsible for planning and scheduling the works under its scope. The main contractor is also responsible for preparing the site construction schedule and co-ordinating the works together with the other contractors and the employer. The approved construction schedule will be followed by all the parties to the project and, except for minor refinements, changing the schedule shall be agreed jointly.

It is common that specific milestones with set dates are agreed between the parties and such milestones are also associated with delay penalties and milestone payments.

5.2 Delays

Both parties have an obligation to notify the other party without delay in the event a party becomes aware of an event or hinder that could cause a delay to the construction project. A party shall notify the other party of the expected duration of the delay and the mitigation actions that the party is planning to carry out in order to prevent the delay.

A delay on the side of the employer may entitle the contractor to an extension, provided that

the contractor has notified the employer of the grounds for the extension and the likely duration of the required extension in writing. In the event there are several reasons which would entitle the contractor to an extension simultaneously, the contract period can be extended only based on the combined effect of these reasons, and the contractor is not entitled to full extension for each reason separately. In the event the delay is due to the employer, the contractor has a right to claim the time-related costs due to the delay to the extent the contractor could not avoid the costs – eg, by re-organising the works on site.

5.3 Remedies in the Event of Delays

According to YSE 1998 terms, in the event of delays, the employer is entitled to claim a penalty. The penalty must be paid for each working day that the construction works remain uncompleted beyond the times agreed. The parties can agree the amount of the penalty as they wish, but YSE terms state the penalties that will be applied unless otherwise agreed.

According to YSE terms, the penalty for delay is 0.05% of the contract price exclusive of value added tax for each working day the works are delayed (0.1% in subcontracts). The penalty for delay shall be calculated for a maximum of 50 working days for the completion of the works, and a maximum of 75 working days if the milestones with set dates are included in the agreement. The employer is not entitled to any other compensation for the delay unless the contractor has acted wilfully or with gross negligence.

5.4 Extension of Time

According to YSE 1998 conditions, the contractor is entitled to request, and thereby can be granted, an extension of time in the following circumstances:

- when there is a threat of delay due to the employer or employer's other contractors (neglect of employer's obligation to collaborate in time);
- additional works or modification works ordered by the employer; and
- events, such as force majeure, that are beyond the reasonable control of the contractor and are not caused by the contractor.

To secure its rights to the extension, the contractor must, without delay notify the employer of the required extension and of the grounds for the extension, at the risk of otherwise forfeiting its right to the extension. The requirement and justification for the extension of time can be established, for example, by means of site journals (containing information on the progress, delays and changes of the contract) and other written evidence, but in most cases the justification for the extension requires a detailed analysis on the effects to the schedule. In addition to the YSE conditions, the parties may specify separate criteria for the extension of time in the building contract.

5.5 Force Majeure

Force majeure is widely recognised as a contractual principle in Finnish case law. A force majeure event is generally an unforeseeable event beyond the parties' control that could not have been reasonably avoided or overcome and that is not attributable to the other party. Force majeure may include events such as war, strike, natural catastrophes, pandemic, etc. It is possible to contractually limit or exclude certain circumstances from being qualified as force majeure.

Under the YSE 1998 terms, force majeure is defined as:

- an exceptional circumstance referred to in the State of Defence Act or the Readiness Act, or a comparable circumstance that causes considerable difficulties for the contractor in engaging employees and procuring construction goods, or otherwise prohibits the execution of the construction contract;
- a strike, boycott or embargo preventing the works of the subcontractor or the delivery of a supplier;
- a lockout or other similar industrial action materially preventing the works from being carried out;
- exceptional weather conditions seriously inconveniencing the contractor's work; or
- other exceptional circumstance beyond the control of the contracting parties that creates a significant difficulty in fulfilling the obligations and that could not have been taken into account beforehand, and the effects of which the contracting party may not reasonably eliminate.

In case of force majeure, the contractor is entitled to suspend the works and receive an extension to the agreed completion time and milestones, but only part of the costs incurred by the contractor due to such suspension are covered by the employer.

The parties are entitled to terminate the contract if it is necessary to interrupt the construction works for a long and indefinite period on account of a force majeure event.

5.6 Unforeseen Circumstances

Unforeseen circumstances are not governed by mandatory or regulatory law. The subject is contractually agreed upon by the parties. Unforeseen circumstances may qualify as a force majeure event if the conditions mentioned in 5.5 Force Majeure are at hand.

5.7 Disruption

According to YSE 1998 terms, a contractor has the right to obtain a reasonable extension to the agreed schedule, if the employer causes a delay – eg, by not providing the necessary approvals in a timely manner. The same right also rests with the contractor when any other contractor or supplier contracted by the employer causes a delaying disruption at the site. However, to secure its right to the extension, the contractor must notify the employer of the required extension and of the grounds for the extension, at the risk of otherwise forfeiting its right to the extension. It is the obligation of the contractor to establish both the existence and the duration of the disruption and its causal connection to the required extension.

6. Liability

6.1 Exclusion of Liability

According to Finnish general legal principles and case law, damages caused by wilful misconduct and gross negligence cannot be contractually excluded. In addition, parties cannot exclude their liability based on the mandatory Product Liability Act, which is also applicable in the field of construction.

6.2 Wilful Misconduct and Gross Negligence

Wilful misconduct and gross negligence exist under Finnish law. The terms are defined in the Criminal Code and the concepts are also well established under contract law and form a firm principle of the type of liabilities, which cannot be contractually excluded. Based on the freedom of contract principle, parties can agree on limitations of liability under a contract, except to the extent a party has acted wilfully or with gross negligence.

6.3 Limitation of Liability

Parties can agree contractually on limitations to their liability. However, in the construction field, extensive limitations to one's liability are quite exceptional and limited in their content.

Under YSE 1998 conditions, there is only limitation regarding damage that could not have been avoided even if the party had acted in all due care. According to YSE terms, a contracting party shall not be liable for any damage that it could not have avoided, even if it had taken all possible care.

Liability to a Third Party

The same principle also applies to the contractor's liability to a third party.

Under YSE 1998 terms, the contractor is liable for any loss, damage or harm caused to a third party and to the third party's property during the construction works. The contractor is not, however, liable for loss, damage or harm that is an unavoidable consequence of the work that had to be carried out and that even by taking the utmost care, the contractor could not have avoided.

The contractor is nevertheless liable for any loss or damage irrespective of negligence for which the liability results from mandatory law, such as the Product Liability Act.

7. Risk, Insurance and Securities

7.1 Indemnities

In construction projects in Finland, indemnity clauses are typically used only as regards to damage caused to third parties in relation to personal injury, death or damage to property.

7.2 Guarantees

Typically used guarantees under construction projects are guarantee for construction period and guarantee for warranty period, and at times advance payment guarantee.

Under YSE 1998 terms, the guarantee for the construction period is 10% and the guarantee for the warranty period is 2% of the construction price excluding VAT. A guarantee can be provided by a bank or other financial or insurance institution, or it can be a deposit of money in a financial institution. A parent company guarantee does not qualify for a guarantee unless the parties agree that such guarantee is sufficient. Generally, on-demand guarantees are not used in the construction industry, except in complex projects.

Providing guarantees can apply to both of the parties depending on what has been agreed, but it is typical that at least the contractor will provide the guarantees. In the event the parties agree that the employer shall provide a guarantee for its contractual obligations, the amount of guarantee is 10% of the contract price exclusive of VAT under YSE terms.

7.3 Insurance

According to the YSE 1998 terms, the contractor is obliged at its own expense to take out insurance for the replacement value of the building project, construction products and working materials procured for the purposes of the works. However, the parties may agree to deviate from this main rule in the construction contract.

Insurances for a Construction Project

Unless otherwise agreed, the contractor responsible for site management duties is obliged, at its own expense, to take out insurance for the replacement value of the building project and

construction products, and any working materials procured for the purposes of the works under the agreed scope.

The insurance must also cover any subcontracts, as well as procurement of goods and services by the employer and other insurance objects specified in the contract documents. If the project does not have a contractor responsible for site management duties, each contractor shall be responsible for insurance covering its own work.

The employer notifies the contractor of the estimated value of the nominated subcontracts, procurement by the employer and other objects of insurance in the invitation to tender.

If the value of an insurance object changes significantly, the insurance sum shall be adjusted in line with the value of the object. The corresponding change in the insurance premium must be covered or reimbursed to the contracting party.

The insurance shall be taken out as contractors' all-risk insurance or other indemnity insurance that covers the insurance object for unforeseeable events such as loss due to a fire or malicious damage, including demolition and clearance costs. The insurance must remain in force until the entire insured building project is handed over, and it must also cover loss or damage arising from any work undertaken after the handover during the guarantee period. The general responsibility for the insurances after the handover lies with the employer/building owner.

Insurance must be taken out in the building owner's name from a financially sound insurance company that engages in general insurance activity in the country in which the building project is located. The sum insured must

at all times correspond to the full value of the insurance object, including any additional and modification work. Unless otherwise agreed, the deductible in the insurance may not exceed 0.5% of the contract price between the contractor and the employer.

The insurance policy or the certificate issued by the insurance company pertaining to the insurance that is in force must be provided to the employer before instalments payable on any work or procurement can be made.

Subcontractors are obliged to take insurances for the building project as separately agreed. In addition, all the contractors working on the site shall have valid business liability insurance.

Insurances for Repair Work

Unless otherwise agreed, the contractor's insurance obligation in repair work of older structures is limited to the value of the repair. The building owner must notify the contractor of any valid buildings insurance and further notify the insurance company of the repair work.

Each contractor shall itself be responsible for insurance of its construction equipment and also for insurance of its construction products and working materials in repair work.

7.4 Insolvency

Under YSE 1998 conditions, both the employer and the contractor have the right to terminate the contract if the other party is declared bankrupt, or it is otherwise deemed likely that the party is unable to fulfil its contractual obligations.

In the event it is deemed likely that the party is unable to fulfil its contractual obligation due to insolvency, the party may avoid the termination

by providing a sufficient surety to secure the performance of its obligations.

7.5 Risk Sharing

In Finland, the parties are free to agree on risk allocation in the contract as they deem fit. Using model agreement templates that are fit for certain types of construction project, and general terms such as YSE 1998 terms, risk is allocated based on the chosen agreement model and construction project type. There are no general principles for pricing of shared risks in Finland although the standard contract templates (published by the Confederation of Finnish Construction Industries RT) form a base for the risk allocation between the parties. The pricing of shared risks depends on the type of construction project and contract and what has been agreed between the parties.

Project alliance is a relatively popular project delivery model in Finland. In this delivery method the parties assume joint responsibility for the design and construction of the project. The joint responsibility is realised through a joint project management organisation and a contract according to which the parties share both positive and negative risks related to the project.

8. Contract Administration and Claims

8.1 Personnel

Under the YSE 1998 terms, there are number of obligations directed to the contractor regarding personnel working on the construction project.

First, the contractor must have a sufficient number of skilled employees to carry out the building contract works. The contractor is obliged to provide the employer with information concerning the number of persons working on site and all

persons must have an individual identifier when on site.

Management Obligations of the Contractor

The contractor responsible for site management duties must have a foreman in charge of the building site who manages the building work and is responsible for ensuring that the work is carried out in accordance with the Building Act, the Building Decree and the building regulations.

Each contractor must operate with management that is sufficient and competent for the demands of the building contract works and must appoint a person in charge of the work for the full period of the construction. The employer must be able to contact the contractor's representative, and the representative must always be available on site as required.

Health and Safety at the Site

The contractor responsible for site management duties must appoint a person responsible, for example, for ensuring that the general management on the site is sufficient from a health and safety perspective.

In addition, each subcontractor must appoint a competent and accountable person for the management and supervision of its work, who shall be responsible for observing the rules concerning health and safety at the site.

If a person employed by the contractor proves incompetent or unsuitable to the extent that the work performance suffers and the matter is not rectified after a written notice from the employer, the person must be replaced with another more competent person.

In addition to the conditions in YSE terms, in Finland there is the mandatory Act on the Con-

tractor's Obligations and Liability when Work is Contracted Out, which also needs to be complied with in construction projects. The purpose of the act is to promote fair competition between companies, as well as compliance with terms of employment on the labour market.

Before concluding the agreement, the contractor must ensure that its subcontractors comply with their statutory obligations. Compliance with obligations is verified by providing the information listed in the Act on the Contractor's Obligations and Liability when Work is Contracted Out:

- documentation on whether the contracting partner is entered in the Prepayment Register and Employer Register, and registered as VAT-liable in the Value Added Tax Register;
- extract from the Trade Register;
- report on tax payment status;
- certificates of pension insurance taken out and of pension insurance premiums paid;
- documentation of the collective agreement or the principal terms of employment applicable to the work;
- documentation on the provision of occupational healthcare services; and
- certificate indicating that insurance has been taken out pursuant to the Finnish Workers' Compensation Act.

Each contractor is responsible for obtaining these reports and documents from their subcontractors.

8.2 Subcontracting

Subcontracting is widely used in the Finnish construction industry and thus all Finland's general terms and industry standards acknowledge the use of subcontractors.

YSE 1998 Conditions

Subcontracting is allowed under YSE conditions. However, the contractor must obtain an approval from the employer for the main subcontractors. The leverage of the employer when choosing the subcontractors is, however, limited, since the employer can refuse to approve the subcontractor only with a due cause.

The due cause can exist – eg, due to the subcontractor's failure to fully comply with the provisions on quality assurance, or neglect in payment of taxes or employer's contributions.

The contractor shall assume responsibility for any works carried out by the subcontractors and further ensure that duties performed by the subcontractors are carried out in accordance with the time schedule.

KSE 2013 (Construction Consultation, Design)

According to the KSE 2013, the consultant is not entitled to use another consultant as a sub-consultant while performing its duties without the client's consent. The client's consent is not required when subcontracting routine or minor tasks under the consultation agreement.

If subconsultants are used, the consultant shall inform the client of this. The consultant is liable for the subconsultant's work as if it were its own.

8.3 Intellectual Property

As for intellectual property rights, YSE 1998 terms only govern copyright. According to YSE terms, the basic principle is that each contracting party shall retain the copyright for their own drawings and other planning documents. Using the other party's planning documents in other projects is prohibited without the party's permission.

Also, according to the KSE 2013 terms, which are widely used in construction consultation and design agreements, the client may not utilise the materials delivered by the consultant for another object or purpose than the one specified in the contract without the consultant's consent.

Under the KSE 2013 terms the client is, however, entitled to any invention created during research or development efforts in the course of the agreed assignment. The consultant is entitled to additional compensation if the client's right to the invention proves to be substantially more valuable than the compensation paid to the consultant. Miniature models and other illustrative materials paid for by the client are considered to be the property of the client.

9. Remedies and Damages

9.1 Remedies

There are several remedies governed under the YSE 1998 conditions in the event of breach of contract. The remedy available depends on the type and severity of the breach.

Contractor's Breach of the Agreement

If the contractor neglects to fulfil one of its obligations under the contract, the employer is entitled to fulfil the obligation at the expense of the contractor, if the contractor fails to rectify the situation within a reasonable time limit after receiving a written notification from the employer of the breach.

The employer may claim the expenses related to the neglect from the contractor either by setting off an equivalent amount of the contract price as being paid, or by debiting the expenses separately from the contractor.

Employer's Breach of the Agreement

In the event the employer fails to pay the works in time or in the event the employer otherwise breaches its obligation under the contract, the contractor may claim the costs for the breach from the employer and suspend the works, provided that the contractor has notified the employer of the breach in writing and the employer has not corrected the neglect within a reasonable time.

Termination of the Agreement

Both contractor's and employer's material breach of the contract may lead to a situation where the other party is entitled to terminate the contract as a remedy. YSE conditions include detailed provisions concerning situations where the termination of the contract can be used. The contractor is also entitled to temporarily interrupt the work as a remedy instead of termination of the contract.

Before the contract is terminated, the party must draw the other party's attention to the termination threat by notifying the other party in writing of the threat to terminate the contract, unless the neglect is corrected within a reasonable time.

9.2 Restricting Remedies

In Finland, it is not very common to contractually limit the remedies available to a party under general terms of YSE 1998. However, as the general terms are relatively old and do not always provide a sufficient protection for the parties' rights in today's projects, it would be recommended to carefully assess whether any modifications to the YSE 1998 terms would be necessary and especially consider whether the allocation of risk and remedies available are sufficient.

9.3 Sole Remedy Clauses

Sole remedy clauses are not typical in construction contracts in Finland.

In relation to delay, the employer's options for remedy are usually limited to claiming liquidated damages (delay penalty). In the event of delay, the employer may not seek for any other damages except the agreed delay penalty, and this could be seen as a sort of a sole remedy clause. However, if the delay is due to wilful misconduct or gross negligence, the liability of the contractor is not limited solely to the delay penalty, but the employer can also claim damages caused due to the delay.

9.4 Excluded Damages

Unless the parties have agreed otherwise in the construction contract, there are no limitations of the type of damages that a party is obliged to compensate due to a breach of the agreement. As a general rule, the parties are entitled to the full compensation with no maximum cap in the event of contract breach, unless otherwise stated in the construction contract. A contracting party is not, however, liable for loss or damage that it could not have avoided even by taking the utmost care.

However, as explained in 5.3 Remedies in the Event of Delays, the contractor's liability for delay is limited to the obligation to pay a delay penalty unless the delay is caused wilfully or by gross negligence.

9.5 Retention and Suspension Rights

As mentioned in 5.5 Force Majeure, under YSE 1998 conditions the contractor has the right to temporarily interrupt the work until it can be seen whether the force majeure event will inevitably lead to termination of the contract. In such cases the contractor must provide a written notice to the employer stating the cause for the interruption.

The contractor is entitled to suspend the contract works temporarily if the employer does not

fulfil its payment obligation or any other obligations that materially affect the execution of the building contract, or if the employer through its actions prevents completion of the construction works in accordance with the contract.

The contractor is also entitled to suspend the works if the employer is deemed to be in a situation where it cannot be expected to appropriately fulfil its contractual obligations. The employer can avoid the suspension by providing a reliable additional surety or a report of the fulfilment of the obligations within one week of the contractor's written notification of the suspension.

As for the employer, it is a common remedy for employers to withhold a payment or set off a claim from the agreed payments in the event the employer has a claim against the contractor due to a contract breach such as delay.

9.6 Termination

YSE 1998 terms include detailed provisions concerning situations where the termination of the contract for cause can be applied.

According to YSE terms, the employer has the right to terminate the contract – eg, if the contractor does not commence the works in the agreed schedule or if the works are being carried out so slowly that it is apparent that the works cannot be completed in the agreed time, except if this is due to reasons that would entitle the contractor to an extension. In addition, the employer may terminate the agreement in the event the contractor has not provided the agreed guarantee to the employer in time.

The contractor has the right to terminate the contract – eg, if the employer does not fulfil its payment obligation, or other obligation substantially affecting the performance of the contract.

The termination is only possible in the event the party in breach has not remedied the situation within reasonable time after receiving a written termination notification from the other party.

In the event the contract is terminated for cause, the breaching party shall compensate all the damages and costs due to the termination to the other party in full.

10. Dispute Resolution

10.1 Regular Dispute Resolution

If nothing else is agreed in the construction contract between parties, the respective district court is competent to adjudicate disputes related to construction contracts.

10.2 Alternative Dispute Resolution

It is possible and fairly common for the contracting parties to agree on alternative dispute resolution means in the construction contract.

Arbitration is commonly used in the larger construction project contracts and the YSE 1998 conditions also include provisions concerning arbitration. If arbitration is used as a dispute resolution method, it is typical to agree on the arbitration procedure in accordance with the Rules of the Arbitration Institute of the Finnish Chambers of Commerce. Arbitration procedure is governed by the Finnish Arbitration Act.

In addition, parties may agree on dispute resolution by means of mediation and different kinds of mediation clauses have become increasingly popular in construction contracts, partly due to the high costs related to other dispute resolution alternatives.

Trends and Developments

Contributed by:

Rosa Lång, Juho Lönnblad, Helena Kalmanlehto and Alisa Montonen
Lieke Attorneys Ltd

Lieke Attorneys Ltd is a law firm with a focus on energy and infrastructure, construction, public sector and dispute resolution. Lieke's Real Estate and Construction team has vast experience in real estate and construction-related contract law, project management and dispute resolution. The team advises clients in notable energy and industry development projects as well as complex construction projects of private and public sector clients. The team is ex-

perienced in public procurement issues in the construction sector and has further experience in zoning, permitting and environmental topics. Lieke's Construction team operates closely with its Energy and Infrastructure, Public Procurement and Dispute Resolution practices. This approach minimises risk in construction projects, avoids disputes and improves the competitiveness of its clients. The team comprises three partners and eleven other experts.

Authors



Rosa Lång is a partner, attorney-at-law at Lieke and specialises in construction law, project management and commercial contracts. Lång also advises Lieke's clients on

employment law issues. She is an experienced negotiator both in the contract negotiation phase and in dispute resolution situations. In addition to domestic assignments, she has experience in numerous international projects. Lång has worked for several years in an international construction group as legal counsel for the Nordic and Baltic companies of the group. She has also worked in compliance and GDPR functions, as well as in risk management.



Juho Lönnblad is a partner, attorney-at-law at Lieke and is a well-respected professional in the real estate and construction industry and in legal project risk management. Lönnblad focuses

on construction and real estate projects, with a particular emphasis on providing clients with comprehensive legal and strategic advice and legal risk management services during projects. He also has solid experience in resolving real estate and construction-related conflicts by negotiations, ADR, arbitration and public court procedures.

Contributed by: Rosa Lång, Juho Lönnblad, Helena Kalmanlehto and Alisa Montonen, **Lieke Attorneys Ltd**



Helena Kalmanlehto is a counsel, attorney-at-law at Lieke and specialises in conflict management and commercial dispute resolution, especially in construction. Kalmanlehto

advises clients on all phases of legal conflicts in several fields of law and industries, such as real property, construction and engineering, supply agreements and trade, shareholders' and share purchase agreements, insolvency situations and protection of creditors' rights, as well as general contract law, damages and liability issues. She has trained in the District Court and Court of Appeals and is an approved mediator for the Finnish Bar Association.



Alisa Montonen is a managing associate, attorney-at-law at Lieke and specialises in the energy and infrastructure sector as well as real estate arrangements and construction

law. Montonen's assignments typically concern the planning, permitting and construction of large energy and other projects, contract negotiations, conducting related merger and acquisition processes, as well as real estate environmental law advice and assisting in appeal processes. Montonen is a member of the Finnish Bar Association's Expert Teams of Environmental Law and Property and Construction Law as well as a member of the Finnish Wind Power Association's offshore wind committee.

Lieke Attorneys Ltd

Aleksanterinkatu 11
(entrance Kluuvikatu 6 A)
00100 Helsinki
Finland

Tel: +358 50 573 5373
Email: attorneys@lieke.com
Web: www.lieke.com/en/

LIEKE

General Trends in the Real Estate and Construction Sector

As during the previous year, uncertainty has been a clear characteristic of the past year in the real estate and construction sector. As financing costs have remained on a higher level than prior to the COVID-19 outbreak and Russia's invasion of Ukraine, the stagnation in commencing new commercial and housing projects has continued and many ongoing projects in the field have faced profitability challenges. At the same time, infrastructure and energy projects still seem to be largely unaffected by the stagnation. The overall picture for the housing market continues to be challenging as the interest rates have risen at a historically fast pace, which has had a negative impact on consumer confidence.

Due to the long-lasting stagnation especially in the housing sector, some actors have faced solvency issues and the number of bankruptcies in the construction sector has substantially increased.

During the past year, the partial reform of the Land Use and Building Act has taken some steps forward but even before the new Building Act has come into force, the legislature is already preparing an amendment package, also known as the "Repair Kit", which is expected to come into force on 1 January 2025, simultaneously with the new Building Act.

Insolvency Aspects in the Spotlight

Due to the market situation described above and its adverse effects, particularly on the housing sector, the insolvency law-related aspects have become relevant in contract drafting, project risk management and conflict situations. At times, the terms and conditions in the industry standard YSE 1998 are in contradiction with the Finn-

ish mandatory legislation, which needs to be taken into consideration.

Under Finnish law, surety or guarantee provides the employer an effective protection against insolvency of a contractor. In principle, a creditor who holds a surety or a guarantee is entitled to full payment up to the amount of the surety or guarantee in the event of the debtor's insolvency.

The widely applied YSE 1998 industry standard terms contain provisions regarding the constructor's obligation to lodge surety during the construction and during the following guarantee period. The surety amounts are determined based on the contract price. From the point of view of the employer, the surety amounts under these conditions are often considered rather low and a recent trend can be seen where the employer seeks to negotiate higher surety amounts to construction agreements. In practice, the sureties provided by contractors are often personal guarantees or suretyship insurances. On-demand guarantees have lately become more common, but are mostly used in large project deliveries. Under YSE 1998 terms, the employer is also entitled to require additional surety from the contractor, inter alia in case the amount of additional works and modifications have a notable impact on the contract price. However, it is not uncommon that sureties have not been updated during the project, which may lead to detrimental consequences in case of the opposing party's insolvency. The employer also has the right to withhold the contract price if the surety or additional surety is not provided. The employer should also note that failure to lodge the surety or the required additional surety is also a ground for termination under the YSE 1998 terms. This ground for termination is quite clear in comparison with other, more vague grounds for termination under YSE terms, which is why

it is to the advantage of the employer if it can be invoked.

The Finnish Bankruptcy Act entered into force in 2004; ie, after the YSE 1998 terms had been introduced. The Act contains mandatory provisions relating, inter alia, to the effect of the bankruptcy on the debtor's contracts and the assets belonging to the bankruptcy estate. Some of the mandatory provisions of the Bankruptcy Act (and the principles that had already been adopted before the Act) conflict with some of the conditions set out in the YSE 1998. In practice, this means that some provisions of YSE 1998 terms cannot in practice be applied, if the bankruptcy estate wishes to exercise its rights under the Act.

According to the YSE 1998, the employer is entitled to terminate the contract, inter alia, if the contractor is declared bankrupt. Similarly, the contractor is entitled to terminate the contract if the employer is declared bankrupt. However, the Bankruptcy Act provides the bankruptcy estate a right, under certain conditions, to step in and continue the debtor's contract, in which case there is no right of contract avoidance by the other party, regardless of YSE 1998 conditions providing the opposite. Termination of the contract in such situation constitutes a breach of the contract, which may cause liability towards the bankruptcy estate.

In addition, the YSE 1998 terms provide for the right of the employer, in case of contract avoidance, to take possession of the site and its building materials, and to use these to continue the work against market-price level compensation to the contractor or its bankruptcy estate. They also provide the employer a right to set-off this compensation against any claim for damages, which the employer may have against the contractor under the contract.

Under the Bankruptcy Act, the estate administrator takes possession of the debtor's assets, which are liquidated and distributed to creditors in the order prescribed by law. Due to the mandatory nature of the law, the employer cannot take possession of the debtor's assets on the construction site, but the bankruptcy estate shall be determined on the debtor's assets on site. If the bankruptcy estate decides not to commit itself to continue the contractor's work, it is common in practice for the bankruptcy estate to hand over the goods to the employer for a fair compensation. This also serves the bankruptcy estate's purposes, as it allows it to liquidate the debtor's assets efficiently and at a relatively good price.

In addition, the right of set-off referred to in YSE 1998 terms is not always necessarily available to the employer, due to mandatory law. Under the Bankruptcy Act, set-off is only possible if the basis for both the employer's damages claim and the redemption price for the building materials arose prior to the contractor's bankruptcy. According to the preliminary ruling of the Supreme Court of Finland, the employer has this set-off right under YSE 1998 terms only, if the avoidance of the contract and the takeover of the site were both carried out before the bankruptcy was declared. The existence of a right of set-off can be of great financial importance for the employer, as it means that the employer does not have to pay the bankruptcy estate a compensation for the supplies on the site to the extent that the damages suffered by the employer exceed this amount. If there is no right for the set-off, the employer potentially will have to place a significant payment to the bankruptcy estate and will have to lodge and collect its own claim for damages in the bankruptcy proceedings, for which the expected payment may be very small, typically 10–12% of the claim amount.

Approved Reform of the Finnish Building Legislation

The new Building Act, adopted by the Finnish parliament on 1 March 2023, will enter into force on 1 January 2025.

The reform is also tied to other new pieces of legislation, namely concerning an information system for the built environment, focusing on digitalising the building authorities' processes, as well as a system for demonstrating the competences of designers and supervisors in the construction sector.

Below is a summary of the main legislative changes presented by the new Building Act.

A limited number of significant changes

Although the Building Act constitutes a comprehensive reform of the Finnish building legislation, many of the principles and a large part of the contents of the current Land Use and Building Act will remain substantially unchanged although the content of the Act will be divided into several separate acts. In addition, despite the change in the name of the current Land Use and Building Act to the Land Use Act, the contents of the legislation concerning land use will remain unchanged. However, a reform of the Land Use Act is under way as well, expected to advance in several stages during the upcoming years.

The main changes to the substance of the construction legislation introduced by the new Building Act comprise the following.

- The permitting structure will be simplified and move towards a more digitalised model.
- A new role will be introduced, namely the implementer entrusted with the main responsibility for a project, who will bear the statu-

tory responsibility for the implementation of a construction project as a whole.

- New essential technical requirements concerning a building's life cycle and carbon footprint will be introduced.
- A new register for the competences of designers and supervisors in the construction sector will be used.
- The new Building Act will regulate market surveillance for construction products.

The Building Act includes a number of references to decrees to be issued by the government and the relevant ministries. Such decrees will specify in more detail the contents of the Building Act in several areas. However, the contents and timing of most of these decrees are, to date, not known.

The three first amendments listed above form the most significant changes to the legislation in practice and were discussed in more detail in our [Trends and Developments 2023 chapter](#).

Practical effects of the reform

The widely used standard-form construction agreements will need to be adjusted to take into account the introduction of the new statutory role of the main responsible implementer, if adopted into the legislation (see also below). Simultaneously, the discussion within the construction sector on the need to renew the "General Conditions for Building Contracts YSE 1998" (YSE) has been revived. However, no firm decisions have yet been made among the market participants on whether the YSE terms will undergo a comprehensive or more limited reform, or any reform at all. It remains clear, however, that even though the YSE terms are to be updated, the process will take some years.

In addition, the new Building Act will require actors in the construction sector to ensure they

have the equipment and tools necessary to comply with the digital reforms which are underway. Market participants may need to prepare for the need for – eg, software to enable the production of data models which fulfil the building authorities’ requirements. Although the entry into force of the Building Act was pushed forward by a year to January 2025 to ensure that, among other parties, the public authorities also have time to adjust, projects for which construction permits will be applied in 2025 will soon commence. Involved parties will need to take the changing legal environment into account both in their day-to-day operations and their project-specific contracts.

Building Act “Repair Kit” already being prepared

Even before the new Building Act has come into force, it has been widely recognised that the new law would benefit from a number of amendments and clarifications. For example, there has been a concern that the new requirements concerning permit processes are somewhat ambiguous and may cause additional administrative work required by the law.

To alleviate these concerns, the legislature is preparing an amendment package, also known as the “Repair Kit”, which is expected to come into force on 1 January 2025, simultaneously with the new Building Act.

The expected key changes in the Repair Kit concern the following main topics.

- Accelerating and simplifying the building permit process, with a deadline of three months for processing permit applications (expected to enter into force as of 1 January 2026).
- Removing the legislation concerning the responsibility of the main contractor.
- Relaxing requirements related to the carbon footprint and lifecycle characteristics of buildings and introducing a 12-month transitional period for the carbon footprint calculation requirements.
- A new “clean transition investment permit” to simplify and accelerate permitting processes for certain industrial projects.
- Adjusting the transitional periods for certain digitalisation reforms.

The legislature aims to submit the proposal to the parliament for consideration in September, and the law is expected to come into force on 1 January 2025. In spring 2024, there is some concern that this schedule may prove too optimistic.

GREECE



Trends and Developments

Contributed by:

Theologos Mintzas, Euripides Ioannou, Valia Anastasopoulou, Anastasia Bolari, Iliia Aikaterini Boura, Nikolaos Kampantais and Vasilis Tsintavis

POTAMITISVEKRIS

POTAMITISVEKRIS is one of the largest full-service law firms in Greece with a leading presence in key market sectors and practice areas, providing advice across a full spectrum of legal issues. The firm's success is evidenced by its recognition as "Greece Law Firm of the Year" for five years by Chambers Europe. Its real estate and construction practice provides expert guidance on a broad spectrum of real estate transactions. Services cover legal due diligence, environmental law, urban planning, zoning, forestry, seashore, building permits, leases, acquisitions, construction and development contracts, li-

cences, management agreements and real estate mergers and acquisitions. Recognised as Band 1 in Chambers Europe, the team comprises six associates and two partners. The firm's project finance and energy practice leverages deep regulatory expertise in energy, greenfield infrastructure concessions and public-private partnerships. The team has advised on energy projects exceeding 5,000 MW, major motorway and freight train terminal concessions, as well as the Hellinikon project, Europe's largest real estate development. The team comprises nine associates and two partners.

Authors



Theologos Mintzas is a real estate expert advising domestic and foreign investors and international funds on a wide range of transactions, including acquisitions, disposals and

leases of portfolios and individual assets and other real estate investments, as well as on property management, construction and development. He leverages his expertise in environmental, building, planning and zoning law and relevant regulatory matters to help clients successfully conclude all types of real estate transactions. Theologos has been involved in numerous landmark real estate transactions and has significant experience in the privatisation of public assets, as well as M&A. He joined POTAMITISVEKRIS in 2011 and has been a partner since 2021.



Euripides Ioannou is the head of structured finance, projects and energy practice at POTAMITISVEKRIS. His experience includes acting on a wide range of complex project

and structured finance transactions, upstream oil and gas projects, and acquisitions. He advises clients on public-private partnerships, infrastructure, construction, oil and gas, energy regulation and environmental matters, waste management, renewable energy and real estate projects. He joined the firm in 1999 and has been a partner since 2008.

GREECE TRENDS AND DEVELOPMENTS

Contributed by: Theologos Mintzas, Euripides Ioannou, Valia Anastasopoulou, Anastasia Bolari, Iliia Aikaterini Boura, Nikolaos Kampantais and Vasilis Tsintavis, **POTAMITISVEKRIS**



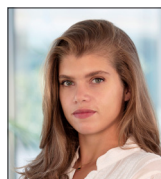
Valia Anastasopoulou focuses her practice on real estate, dispute resolution and corporate law and commercial contracts. She has significant experience in real estate and commercial

transactions, including due diligence, property acquisitions, establishment of in rem securities on real estate assets, commercial and residential lease agreements, as well as various types of contracts. She also advises clients on issues related to management of real estate portfolios and relevant development plans. Valia has participated in interim measures petitions and court injunctions to secure real estate rights, in litigation on commercial disputes, and in cases on the recognition of the enforceability of a foreign precedent. She was admitted to the Athens Bar Association in 2016.

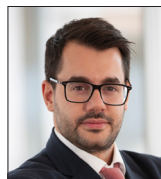


Anastasia Bolari is a member of the corporate, mergers and acquisitions and real estate practice groups at POTAMITISVEKRIS. Anastasia has extensive experience in

property management, construction and development agreements. She actively engages in the drafting, negotiation and provision of customised legal counsel to clients within these specialised practice areas. She also advises on several aspects of corporate transactions. Anastasia has been involved in innovative transactions representing both private and public sector clients. She has experience in drafting and negotiating share purchase agreements, shareholder agreements and ancillary contracts, and undertaking all necessary formalities to ensure successful implementation of acquisitions. She was admitted to the Athens Bar Association in 2018.



Iliia Aikaterini Boura is a member of the environmental law practice group at POTAMITISVEKRIS. She advises on all areas of public and administrative law, including environmental law, building, planning, zoning law and public procurement. She also advises clients on constitutional law, cultural heritage law, media law, competition law, as well as EU law and ECHR law. Iliia has participated in significant environmental law cases, mainly in the areas of renewable energy, quarrying, mining, land use and planning law, public procurement and media law. She has also handled cases before the European Court of Human Rights. She was admitted to the Athens Bar Association in 2017.



Nikolaos Kampantais is a member of the structured finance, projects and energy practice group at POTAMITISVEKRIS. He possesses experience in large-

scale, complex and cross-border transactions within the energy, infrastructure, and hospitality sectors. Nikolaos supports both domestic and international clients, offering expertise in structuring financing, preparing necessary documentation, and achieving financial closing. He is experienced in LMA and ISDA documentation and advises on the drafting and negotiation of complex project documentation, including EPC and O&M agreements, as well as corporate PPAs. He has advised on financing transactions related to the development of renewable energy and hospitality projects, airports and marinas. He was admitted to the Piraeus Bar Association in 2018.

GREECE TRENDS AND DEVELOPMENTS

Contributed by: Theologos Mintzas, Euripides Ioannou, Valia Anastasopoulou, Anastasia Bolari, Iliia Aikaterini Boura, Nikolaos Kampantais and Vasilis Tsintavis, **POTAMITISVEKRIS**



Vasilis Tsintavis is a member of the project finance and energy practice group at POTAMITISVEKRIS. He has successfully advised domestic and foreign sponsors and financiers in large and complex project financing for infrastructure concessions, public private partnerships, energy and real estate. Vasilis also has experience in advising on

acquisitions and joint ventures in the energy sector. He has acted on behalf of international bidders and awarding authorities in the context of infrastructure and real estate concession tenders. In addition, he has provided legal support to financiers in debt restructuring (both in contractual and pre-insolvency rehabilitation procedures). He was admitted to the Athens Bar Association in 2018.

POTAMITISVEKRIS

11 Omirou Str. 10672,
Athens
Greece

Tel: +30 210 33 80000
Fax: +30 210 33 80020
Email: info@potamitisvekris.com
Web: www.potamitisvekris.com

POTAMITISVEKRIS

Contributed by: Theologos Mintzas, Euripides Ioannou, Valia Anastasopoulou, Anastasia Bolari, Iliá Aikaterini Boura, Nikolaos Kampantais and Vasilis Tsintavis, **POTAMITISVEKRIS**

Introduction

What follows is a presentation of trends and developments in relation to energy projects (renewable and thermal), green buildings and town planning.

Green Building & Town Planning

Green buildings

Until a few years ago, green buildings were a foreign concept in Greece, overshadowed by widespread issues such as haphazard construction and inadequate urban planning. Cities grappled with unauthorised constructions and numerous old buildings that were poorly maintained. These buildings often sat empty and were costly to operate, both financially and environmentally. As a result, Greek residential, office and hotel buildings have been notoriously energy inefficient.

However, this is changing rapidly due to several factors: there is increasing demand for sustainable, energy efficient and environmentally friendly offices, growing demand for modern and luxury housing, and interest from foreign investors in large projects like upgraded hotels, luxury villas, and new logistics and data centres. These pressures compel the Greek construction industry to evolve and align with global standards, catalysing a shift towards sustainable construction.

Such transformation is evident in recent major construction projects across Greece. Old buildings have been repurposed, primarily into hospitality spaces, while eco-friendly office buildings and logistics centres have sprung up, especially around Athens and other major cities. Notable developments include luxury accommodations in the Greek islands and eco-conscious office complexes in urban centres. These projects adhere to high sustainability standards, employing BREEAM and LEED Gold certification methods.

Looking ahead, new constructions in Greece are expected to have a significantly reduced energy footprint.

Town planning law developments

Two recent decisions by the Council of State, the Greek supreme administrative court, have affected the construction sector, mainly by creating ambiguity as to the buildability of certain areas and the total available building coefficient and heights for certain constructions:

Decision 293/2024 by the Council of State

The Council of State ruled that specific provisions in the New Building Regulation Code (law 4067/2012) are unconstitutional. These provisions allow increases in building sizes and heights based on particular construction initiatives, including:

- increased building coefficient if building coverage is reduced;
- increased building height for reduced coverage;
- extensions to basements up to property boundaries;
- additional rooftop space for planting; and
- building coefficient increases for enhanced energy performance.

Such incentives are deemed to violate established constitutional urban planning principles and the protection of residential environments, as stipulated by article 24(2) of the Constitution. Additionally, the Court ruled that these changes conflict with EU Directive 2001/42/EC, which mandates environmental assessments for urban planning laws.

The case has been referred to the plenary session of the Council of State to consider a preliminary

Contributed by: Theologos Mintzas, Euripides Ioannou, Valia Anastasopoulou, Anastasia Bolari, Iliia Aikaterini Boura, Nikolaos Kampantais and Vasilis Tsintavis, **POTAMITISVEKRIS**

nary question to the EU Court of Justice about environmental assessments.

Notably, several Municipalities in the Attica region are already implementing the above (preliminary) decision of the Council of State and deny issuance of building permits applying the discussed incentives.

Decision 176/2023 by the Council of State

This decision clarified the rules for constructing on plots outside urban plans. The key points of the decision are:

- the required minimum plot frontage for building is 25 metres, adjusted from the previous 45 metres;
- this change applied only to plots created after 31 December 2003 – ie, the effective date of law 3212/2003;
- plots created before this law and after the presidential decree of May 1985 are buildable as long as they front onto a legally recognised common-use road, such as international, national, regional, municipal or community roads;
- roads of any classification are considered common property by law.

Considering that most of Greece is not covered by urban planning, this recent judicial decision, while beneficial in terms of policy, has led to a halt in the issuance of building permits that do not meet specified criteria. It is anticipated that the government will introduce new legislation after the upcoming European elections.

Key economic terms

Unlike some jurisdictions that utilise standardised contracts as the FIDIC forms, Greek building contracts are still tailored to the specific

needs of each project and do not adhere to a uniform template.

Having said this, the building process typically unfolds in the following two stages: initially, employers establish agreements with civil engineers and/or architects who are responsible for the overall design of the project. This includes the creation of necessary studies and technical specifications. Following this, employers finalise contracts (main contracts and technical specifications contracts) with contractors who in turn pursue further contracts with various subcontracting professionals for the performance of works, such as earthworks, foundational works, building construction, and the installation of electromechanical, plumbing and fire safety systems, etc.

Contractor compensation may be set as a flat rate or a metered rate, depending on the project's needs and the commercial agreement. A metered rate is often applied when the extent of the work and the materials used cannot be predetermined. In such cases, a maximum fee is agreed upon in the contract, with the final fee not exceeding this cap.

Payments are usually structured in instalments, beginning with a down payment at the time the contract is signed. This is followed by monthly instalments that are contingent on the project's progress, as verified by the employer or project manager. In response to recent inflationary pressures largely attributed to the war in Ukraine, advance payments to contractors have escalated, sometimes comprising up to 10% of the total anticipated fees. This increase in upfront payments enables contractors to secure stable pricing for materials and labour.

Contributed by: Theologos Mintzas, Euripides Ioannou, Valia Anastasopoulou, Anastasia Bolari, Iliia Aikaterini Boura, Nikolaos Kampantais and Vasilis Tsintavis, **POTAMITISVEKRIS**

For large-scale projects with significant fees, contractors often provide a bank letter of guarantee as security for their performance, to be returned or forfeited under the terms outlined in the contract. Additionally, a small percentage of each payment (typically 5% or 10%) is withheld as an additional guarantee of timely project completion. These withheld amounts are returned to the contractor, without interest, after the project's delivery and the signing of the delivery-acceptance protocol, assuming no grounds for forfeiture exist.

Lastly, it should be noted that due to the recent great increase in construction activity, the market is observing a shortage in available personnel and small-scale subcontractors for particular works.

Energy Projects

Renewable projects: from single EPC to multi-contract

The contractual arrangements applied to the construction phase of a project have a significant influence on the total construction cost of a project and the management of design, construction and procurement risks, factors that affect both the returns of the project sponsors and the project's ability to tap senior debt.

Greek banks, although preferring the conventional (but more expensive) lump sum EPC model involving a single contractor who assumes all responsibility for the design, procurement and construction, are open to negotiate different contractual structures that involve multiple construction and procurement contracts. These structures may achieve significant cost savings on the construction budget at the "expense" of foregoing the single liability point offered by the single contractor approach. To that end, Greek banks tend to rely heavily on the technical due

diligence, proven track record and expertise of each of the multiple contractors to deliver on time and within budget, rather than the creditworthiness of a general EPC contractor who would fully underwrite all construction risk.

A typical multi-contract structure for a renewable energy project could include:

- balance of plant (earthworks, electromechanical works and installation of solar panels and inverters for solar projects);
- supply of equipment (wind turbines which are installed by the supplier, solar panels and inverters);
- substation construction; and
- grid connection works (other than the substation).

To mitigate the co-ordination and interface risk inherent in a multi-contract structure, lenders may require the appointment of an experienced construction manager.

In solar projects, where the project company procures the main equipment (modules, inverters) directly from their original equipment manufacturers (OEMs), special attention is to be given to enforcement of warranty claims. If the rights under the OEM warranties remain with the project company, the latter will be required to pursue and enforce warranty claims in the jurisdiction of the OEM which they may not be familiar with (ie, China in cases of the supply of solar project equipment). The project lenders will also be concerned about the likelihood of recovery of warranty claims in foreign jurisdictions against distant counterparties. To address this, the rights under the OEM warranties and the liabilities of the OEM manufacturer are sometimes transferred to the balance of the plant contractor during the construction period, so that

Contributed by: Theologos Mintzas, Euripides Ioannou, Valia Anastasopoulou, Anastasia Bolari, Iliia Aikaterini Boura, Nikolaos Kampantais and Vasilis Tsintavis, **POTAMITISVEKRIS**

project company has recourse against the local creditworthy contractor which is preferred by the project lenders.

Documentation: Construction agreements in renewable project financed transactions in Greece do not necessarily follow standard forms, such as FIDIC. The specific form of such agreements will depend on the selected contractor and the sponsor. Such construction agreements are adjusted to reflect the market practice in Greece and ad hoc particularities. Provisions related to the grid connection process require scrutiny to ensure that the contractor's undertakings are fully aligned with the applicable legal framework and that the employer's obligations towards the grid operator are passed down to the contractor. For renewable energy projects entitled to operating aid, the employer may not be entitled to the operating aid if it fails to achieve commercial operational readiness by a specified date. Therefore, attention is required in structuring critical milestones and providing for longstop date to achieve such milestones. Certain local health and safety related provisions require the alignment of health and safety provisions with the applicable legal framework, such as the appointment of a contractor as safety engineer and health and safety co-ordinator. Extra-contractual (ex lege) obligations which apply as mandatory law pursuant to the Greek Civil Code require special treatment in construction agreements. As an example, indemnity provisions are customarily included to cover situations where the contractor's employees exercise their rights to demand payment of their accrued wages directly from the employer, or that the contractor waives its statutory pledge over the equipment it procures.

Risk of antiquities and permits: There are certain characteristics in Greece that need to be

considered when structuring and negotiating risk allocation principles under the construction agreements, such as the risk of discovery of antiquities, delay from public authorities in issuing project licences or delays from the grid operator in the grid connection process. Due to historical reasons, the risk of discovery of antiquities in Greece is high compared to other countries and contractors are reluctant to assume it. This risk is mitigated (but not extinguished) by obtaining opinions from the antiquity authorities confirming that the project site is in an area of no archaeological interest. Contractors may also be reluctant to assume the risk of delays in the issuance of all project permits and certificates that are required for the start of the commercial operation of the project, or of delays from the grid operator in the grid connection process. In these cases, lenders may require delay in start-up insurance or completion guaranties from the sponsors.

Performance Security: Customarily, the contractor will deliver and advance a payment bond in favour of the employer equal to the amount of the advance payment. The contractor will also be required to furnish a performance bond for a fraction of the contract price (typically 15%-20%). Both bonds are granted as security for the performance of the contractor's obligations to complete the works. Finally, the contractor will be required to provide a warranty bond (typically half the performance bond) as a condition to the acceptance of the works. The warranty bond will remain in place until the lapse of the defects notification period, which is usually two years from take-over of the works, and in certain cases can be extended for up to three years for defects on remedial works.

One of the latest trends is that the contractors request the flexibility to furnish bonds issued by

Contributed by: Theologos Mintzas, Euripides Ioannou, Valia Anastasopoulou, Anastasia Bolari, Iliia Aikaterini Boura, Nikolaos Kampantais and Vasilis Tsintavis, **POTAMITISVEKRIS**

insurance companies instead of banks. A limited number of insurance companies operating in Greece do currently provide such bonds in large-scale renewable energy projects but the lenders are still sceptical on the preferred treatment of such bonds from a bankability perspective. They assess such requests depending on the project and the insurance company which is proposed to issue the relevant bonds. One challenge associated with this new trend is the evaluation of performance risk of the insurance companies in the event that those bonds are forfeited. Certain insurance companies operating in Greece are not rated by independent agencies (such as Moody's, S&P and Fitch). Additionally, there is no long-standing track record demonstrating that recourse against insurance companies is no different compared to the traditional option of bonds issued by credit institutions.

Gas fired plants

As part of its transition towards cleaner energy sources and reduced reliance on coal-fired power plants, there has been a shift in Greece toward natural gas as a cleaner alternative. The latter can also serve as a backup, given the intermittent character of renewables. CCGT technology consists of combining a gas turbine with a steam turbine which uses the exhaust gas from the operation of the former. This leads to higher efficiency compared to a traditional single-cycle power plant. Per the latest (as of January 2024) available data on the website of the Regulatory Authority for Waste, Energy and Water, there are six production licences for CCGT plants using natural gas in Greece, at various stages of development or operation. Five of them are of a nominal capacity over 820 MW. CCGT plants constitute costly and complex projects presenting various challenges for sponsors and lenders. Certain trends have been noted in their development, as follows:

Single EPC contract: Sponsors and banks prefer single point lump sum EPC contracts, enabling them to transfer all risks to a single contractor, thus enhancing the bankability of the project. Such contracts are usually drafted under the FIDIC Silver Book template or follow other precedents familiar to the sponsor with essentially a "FIDIC-like" (or stricter) liability allocation. EPC contractors are predominantly large Greek construction companies, but there have been also cases involving foreign entities. Both single entities and consortia have been employed as EPC contractors. In the latter case, typically joint and several liability applies with regard to all entities comprising the consortium. What has been said above about matters of interest relating to the documentation and risks applicable to renewable projects apply by and large for gas fired plants as well.

Onshore and offshore split in main equipment procurement: In the context of the aforementioned EPC contracts, the supply and installation of turbines are the subject of a subcontract between the EPC contractor and a specialised manufacturer. Such subcontract is usually split into an offshore scope and an onshore scope. The former involves the supply of the equipment and is undertaken by an EU non-Greek party belonging to the manufacturer's group. The installation and related services are undertaken by a Greek subsidiary (or branch) of the manufacturer's group. This split ensures that no VAT is paid on the equipment imported and also provides a better interface with the local employment and construction regulations on the part of the local entity.

Network connections (gas and electricity): Works connecting the plant to the electricity grid and the gas network are usually the subject of a separate subcontract, entered into between

Contributed by: Theologos Mintzas, Euripides Ioannou, Valia Anastasopoulou, Anastasia Bolari, Iliia Aikaterini Boura, Nikolaos Kampantais and Vasilis Tsintavis, **POTAMITISVEKRIS**

the EPC contractor and a local contractor with a relevant track record. Occasionally however, project sponsors manage to persuade lenders that these works are left out of the EPC scope and be the object of a separate agreement. This may create some interface issues, but we have seen the approach being accepted by lenders if they are given comfort about the expertise of the relevant contractor.

HONG KONG SAR, CHINA

Law and Practice

Contributed by:

May Ng, Sandy Au and Marcus Wong

DLA Piper Hong Kong

Contents

1. General p.278

1.1 Governing Law p.278

1.2 Standard Contracts p.278

2. Parties p.279

2.1 The Employer p.279

2.2 The Contractor p.280

2.3 The Subcontractors p.281

2.4 The Financiers p.282

2.5 The Designer p.282

3. Works p.284

3.1 Scope p.284

3.2 Variations p.284

3.3 Design p.284

3.4 Construction p.285

3.5 Site p.285

3.6 Permits p.285

3.7 Maintenance p.286

3.8 Other Functions p.286

3.9 Tests p.286

3.10 Completion, Takeover and Delivery p.286

3.11 Defects and Defects Liability Period p.287

4. Price p.288

4.1 Contract Price p.288

4.2 Indexation p.288

4.3 Payment p.288

4.4 Invoicing p.289

5. Time p.289

5.1 Planning and Programme p.289

5.2 Delays p.289

5.3 Remedies in the Event of Delays p.289

5.4 Extension of Time p.289

5.5 Force Majeure p.290

5.6 Unforeseen Circumstances p.290

5.7 Disruption p.290

6. Liability p.291

- 6.1 Exclusion of Liability p.291
- 6.2 Wilful Misconduct and Gross Negligence p.291
- 6.3 Limitation of Liability p.291

7. Risk, Insurance and Securities p.291

- 7.1 Indemnities p.291
- 7.2 Guarantees p.291
- 7.3 Insurance p.292
- 7.4 Insolvency p.292
- 7.5 Risk Sharing p.292

8. Contract Administration and Claims p.293

- 8.1 Personnel p.293
- 8.2 Subcontracting p.293
- 8.3 Intellectual Property p.293

9. Remedies and Damages p.293

- 9.1 Remedies p.293
- 9.2 Restricting Remedies p.294
- 9.3 Sole Remedy Clauses p.294
- 9.4 Excluded Damages p.294
- 9.5 Retention and Suspension Rights p.294
- 9.6 Termination p.294

10. Dispute Resolution p.294

- 10.1 Regular Dispute Resolution p.294
- 10.2 Alternative Dispute Resolution p.295

DLA Piper Hong Kong has a construction practice that includes an integrated commercial and contentious capability, helping institutions, developers, investors, consultants and contractors to deliver major infrastructure and property development projects. It advises on the whole life of projects - from procurement to dispute resolution, including front-end contract strategy and contract documentation, risk management and dispute resolution. The firm's advice is com-

mercially orientated because it knows the sector drivers and challenges. It is global and covers nearly all the geographical areas where its clients work, with a particular focus on Greater China and Asia. The team consists of specialist trilingual construction lawyers (English, Mandarin and Cantonese), who are well versed in contentious and non-contentious construction issues.

Authors



May Ng heads the Asia construction disputes team at DLA Piper, where she advises both on contentious and non-contentious construction matters and regularly represents

developers, contractors, engineers, suppliers and manufacturers in construction claims. May is recognised by Chambers and Partners 2024 for her “excellent technical knowledge”. She is qualified to practise law in Hong Kong, England and Wales and the Greater Bay Area of the PRC. May has been appointed to the list of arbitrators of the Hong Kong International Arbitration Centre, as well as the panel of arbitrators of the Shanghai Arbitration Commission, the Shenzhen Court of International Arbitration and the South China International Arbitration Centre.



Sandy Au is an of counsel at DLA Piper, where she specialises in all areas of construction law, including advising on contentious and non-contentious matters. Sandy

has more than 15 years of experience in the construction industry and has assisted local and international contractors, consultants and developers in reviewing construction contracts for projects in Hong Kong and Greater China. She also has substantial experience of advising on complex construction claims in mediation, arbitration and court proceedings and receives high praise from clients. Sandy is dually qualified in Hong Kong and is admitted as a solicitor to the Supreme Court of New South Wales, Australia.



Marcus Wong is an associate at DLA Piper, who is qualified in Hong Kong and England and Wales. He is developing a broad practice with a focus on construction law, including both contentious and non-contentious matters. Marcus has advised and represented employers, contractors, subcontractors and

engineers in pursuing and defending construction claims in Hong Kong and the Asia-Pacific region. He has experience in court proceedings, adjudications and arbitrations. Marcus also offers front-end advice to clients and regularly assists with drafting and reviewing contractual documentation for construction projects.

DLA Piper Hong Kong

25th Floor
Exchange Square Block 3
8 Connaught Place
Central
Hong Kong

Tel: +852 2103 0808
Fax: +852 2810 1345
Email: may.ng@dlapiper.com
Web: www.dlapiper.com



1. General

1.1 Governing Law

Key Legislation

The principal legislation governing building works in Hong Kong is the Buildings Ordinance (Cap 123) and its subsidiary legislations.

Site safety is primarily governed by the Factories and Industrial Undertakings Ordinance (Cap 59) and its subsidiary legislation, including key regulations such as the Construction Sites (Safety) Regulations (Cap 59I).

The key legislation governing the protection of the environment in Hong Kong includes the Air Pollution Control Ordinance (Cap 311), Waste Disposal Ordinance (Cap 354), Water Pollution Control Ordinance (Cap 358), Noise Control Ordinance (Cap 400) and the Environmental Impact Assessment Ordinance (Cap 499).

Other legislation that may be relevant to the operation of employers/contractors includes the Competition Ordinance (Cap 619), Immigration Ordinance (Cap 115), Employment Ordinance (Cap 57) and the Employees' Compensation Ordinance (Cap 282).

Common Law

Aside from the key legislation and regulations, the principal laws governing the construction industry in Hong Kong are derived from the common law of contract and tort and the rules of equity.

1.2 Standard Contracts

Standard form contracts (usually with amendments) are frequently used in the construction industry in Hong Kong.

Public Works

The Hong Kong government has endorsed the use of the NEC suite of contracts for all public works since around 2016. According to the Practice Notes for the New Engineering Contract (NEC) – Engineering and Construction Contract (ECC) for Public Works Projects in Hong Kong, published by the Development Bureau (updated in March 2024), the application of the NEC has been extended to public works project procurement after 2016 and the decision and justification as to whether or not to adopt the NEC in capital work contracts should be documented and endorsed by public officials. More than 90% of large-scale public works projects (ie, those with contract value of more than HKD400 million) commenced in 2022 have adopted the NEC form.

For projects commenced before 2016, the Hong Kong government's own standard forms, the Government of Hong Kong General Conditions of Contract (1999 edition) and the various versions covering civil engineering works, building works and electrical and mechanical works, design-and-build contracts and term contracts were commonly used for contracts with contractors, while the Government of the Hong Kong Special Administrative Region Subcontract for Building Works (2000 edition) was commonly used for contracts between the contractor and the subcontractor.

For railway projects, the MTR Corporation Limited has its own set of contract documents.

Private Works

For private works, the Standard Form of Building Contracts (published by the Hong Kong Institute of Architects and the Hong Kong Institute of Surveyors) and the Standard Form for Domestic Subcontract (published by the Hong Kong Con-

struction Association) are frequently adopted to govern employer–contractor and contractor–subcontractor relationships.

Some contractors prefer to use their own standard forms available in the local Chinese language, particularly for contracts with local subcontractors/suppliers.

International Projects

The International Federation of Consulting Engineers (*Fédération Internationale des Ingénieurs-Conseils*, or FIDIC) standard forms of contracts are widely used in construction projects involving international elements and are used in many construction projects in mainland China involving Hong Kong parties.

2. Parties

2.1 The Employer Employers in Hong Kong

The largest employer for construction projects in Hong Kong is the Hong Kong government. The construction market in Hong Kong is also driven by projects initiated by listed local developers as employers.

Employers' Rights and Obligations

Employers' rights and obligations are generally governed by the contracts entered into between employers with their contractors and/or consultants.

In general, the employer's obligations in a typical construction contract in Hong Kong usually include:

- giving possession of the construction site to the contractor on or before the agreed date;

- obtaining the required statutory approvals for commencement of works according to the agreed terms of the construction contract;
- providing information, approvals and instructions to the contractor according to the agreed terms of the construction contract;
- making payments to the contractor according to the agreed payment mechanisms and timetable (eg, upon issuance of payment certificates, final accounts);
- effecting and maintaining the insurance policies against the building and/or the employer's works according to the agreed terms of the construction contract; and
- making payments to the contract upon termination of the construction contract according to the agreed terms of the contract.

The employer's rights in a typical construction contract in Hong Kong usually include:

- the right to recover loss and damages for the contractor's failure to perform or execute the construction works, including liquidated damages for delay subject to extension of time provisions under the agreed terms of the construction contract;
- the right to receive security bond/guarantees/warranties according to the agreed terms of the construction contract; and
- the right to terminate the construction contract in accordance with the agreed terms of the construction contract or upon repudiation by the contractor.

Relationships Between the Employers and Other Parties

In most construction projects in Hong Kong, architects/designers, engineers and/or quantity surveyors would be engaged by the employers for the administration and supervision of the construction contracts with the contractors.

Employers do not generally enter into direct contractual relationships with the subcontractors unless separate warranties/guarantees are executed by the subcontractors and some subcontracts may give rights to the employer for making direct payment to the subcontractors if payments have been withheld by the contractors.

2.2 The Contractor

Contractors in Hong Kong

Contractors working on public works in Hong Kong are required to be listed on the approved list of contractors maintained by the Development Bureau. The contractors are classified into different categories according to their experience and capabilities and many of the public works projects require the contractors, or at least one of the contractors in a joint venture submitting a tender to the project, to be in a certain category to qualify.

For private works, the contractors must be registered in the appropriate categories of registered contractors under the Buildings Ordinance (Cap 123) in Hong Kong.

Contractors' Rights and Obligations

Contractors' rights and obligations are generally governed by the construction contracts between employers and contractors.

In general, the contractor's obligations in a typical construction contract usually include:

- carrying out and completing the works in accordance with the requirements specified in the construction contract and exercising the skill, care and diligence of a competent contractor;
- carrying out the construction works regularly and diligently and completing the works

within the agreed completion date, subject to extension of time provisions under the agreed terms of the construction contract;

- co-ordinating the carrying out of the works by subcontractors;
- preparing, submitting and updating programmes, drawings, payment applications, notices and applications (for extension of time, as well as additional payment), final accounts and other project documents, etc, according to the agreed terms of the construction contract;
- complying with instructions from the architect or other authorised consultants engaged by the employer (including instructions for variations, delay recovery measures, defect rectifications, etc);
- effecting and maintaining the employees' compensation insurance, contractors' all-risks insurance and other liability insurance according to the agreed terms of the construction contract;
- complying with all applicable statutory requirements; and
- delivering security bond/guarantees/warranties according to the agreed terms of the construction contract.

The contractor's rights in a typical construction contract in Hong Kong usually include (but are not limited to):

- the right to receive interim and final payment according to the agreed terms of the construction contract;
- the right to apply and receive extension of time for listed events;
- the right to claim for additional payment arising from qualifying events such as instructions for variations, acts of prevention by the employer, etc; and

- the right to determine employment in accordance with the agreed terms of the construction contract.

Under the Security of Payment (SOP) regime introduced by the Development Bureau in 2021, from 1 April 2022 all public works tenders to be invited from contractors or suppliers on the approved list are required to incorporate SOP provisions, including the contractual rights to refer payment disputes to adjudication and to suspend or reduce progress of work if the admitted amount or adjudicated amount is not received.

In May 2024, the Development Bureau published the Construction Industry Security of Payment Bill (the “CISOP Bill”). The CISOP Bill, once enacted as an Ordinance (which is anticipated to be in early 2025), will introduce provisions to improve contractual payment terms (including prohibiting “pay-when-paid” clauses), establish an adjudication mechanism to resolve disputes quickly, and grant unpaid parties the right to suspend or slow down the progress of work or services under the circumstances specified in the legislation, in order to ensure that all stakeholders can get their entitled payment in a timely manner. The CISOP Bill will generally apply to construction works contracts of value not less than HKD5 million and HKD500,000 for contracts for the supply of related goods or services, subject to certain exceptions under the legislation.

Relationships Between the Contractors and Other Parties

A typical construction contract generally requires the contractor to comply with the instructions of the architect/designer/engineer or other consultants appointed by the employer.

Relationships between the contractors and the subcontractors are typically governed by the relevant subcontracts between the contractors and the subcontractors. The subcontracts very often will provide that the subcontractor is bound to the terms of the subcontract and the main contract and that payment to the subcontractor is contingent upon payment to the contractor by the employer. However, for public works to which the SOP regime applies, any conditional payment provisions in a subcontract (such as a “pay-when-paid” clause) will be ineffective and unenforceable. The CISOP Bill, once enacted as an Ordinance, will prohibit conditional payment provisions in certain contracts for public and private works.

Under the Employment Ordinance (Cap 57) every principal contractor and superior subcontractor are jointly and severally liable for the first two months’ unpaid wages of an employee who is employed by the subcontractor.

2.3 The Subcontractors

Subcontractors in Hong Kong

Subcontractors in Hong Kong are typically smaller local companies specialised in a particular nature or trade of works.

Subcontractors’ Rights and Obligations

A subcontractor is typically required to execute the subcontract works in accordance with the requirements under the main contract between the contractor and the employer and to suit the contractor’s programme. The subcontractor is typically entitled to receive payment after the contractor has received payment from the employer.

For subcontracts of public works to which the SOP regime applies, it is mandatory to incorporate SOP provisions, including contractual

rights to refer payment disputes to adjudication, to suspend or reduce progress of work if the admitted amount or adjudicated amount is not received and to request the government as employer to make direct payment for any unpaid adjudicated amounts.

Relationships Between the Subcontractors and Other Parties

The relationships between the contractors and the subcontractors are typically governed by the relevant subcontracts between the contractors and the subcontractors.

There are usually no direct contractual relationships between the employers and the subcontractors unless the subcontractors are required to execute separate warranties with the employer. The subcontractors are, however, very often bound to both the subcontract and the main contract under the terms of the subcontracts and many subcontracts give rights to the employer for making direct payment to the subcontractors if payments have been withheld by the contractors.

2.4 The Financiers Financiers in Hong Kong

Financiers in Hong Kong are typically commercial banks or institutional investors.

Financier's Rights and Obligations

The financier is not usually a party to the construction contract. However, a financier may require the employer to submit the relevant construction contracts for its approval to ensure there are sufficient safeguards to control the time and costs incurred for the construction project.

Relationships Between the Financier and Other Parties

The relationships between the financiers and the employers are typically governed by the relevant loan/facility agreements and securities executed by the employers. There are normally no direct contractual relationships between the financiers and the contractors or the subcontractors, subject to any step-in rights that may allow the financier (or other beneficiary of such rights) to "step in" the relevant contract in place of the employer, usually in the event of insolvency or default of the employer.

2.5 The Designer Designers in Hong Kong

Designers in Hong Kong are typically international or local architectural consultancy and engineering firms.

Consultants and engineers working on public works in Hong Kong are required to be listed on an approved list maintained by the Architectural Services Department. The consultants and engineers are classified according to their expertise, number of professional staff and years of establishment. Consultants or engineers are required to be registered on the approved list of a prescribed category before they are qualified to tender for public works projects.

For private works, the consultant and engineer must be registered in the appropriate categories of building professionals under the Buildings Ordinance (Cap 123) in Hong Kong.

Designers' Rights and Obligations

Designers' rights and obligations are generally governed by the consultancy agreements between employers and designers or between contractors and designers, as well as derived

from the common law of contract and tort and implied by legislation.

In general, the designer's obligations in a typical design consultancy agreement usually include:

- carrying out the design in accordance with the requirements specified in the consultancy agreement and exercising the reasonable skill, care and diligence of a competent designer experienced in the provision of like services for a project of a similar size, scope and complexity to the project;
- ensuring the design will be fit for the purpose required by the consultancy agreement;
- furnishing necessary drawings and details in time, which will enable the contractor to comply with the obligation to progress and complete the work in accordance with the construction contract;
- the design must be buildable by those likely to be employed to build and in the conditions that can be foreseen;
- taking reasonable care in the design to assess and eliminate reasonably foreseeable risks;
- employing and utilising in the performance of services key personnel specified in the consultancy agreement;
- continuing duty to check that the design will work in practice and to correct any errors that may emerge;
- the employer/contractor shall become the absolute and exclusive owner of the design and all IP rights subsisting therein free from all encumbrances;
- effecting and maintaining professional indemnity insurance and public liability insurance according to the agreed terms of the consultancy agreement;
- complying with all applicable statutory requirements;

- delivering security/bonds/guarantees/warranties according to the agreed terms of the consultancy agreement;
- for a lead consultant, co-ordinating the design of subconsultants/specialists; and
- for design-and-building procurement, consenting to novate all rights and obligations of the consultancy agreement from the employer to the contractor.

The designer's rights in a typical consultancy agreement in Hong Kong usually include (but are not limited to):

- the right to receive payments according to the agreed terms of the consultancy agreement typically under a schedule of fees;
- the right to claim for additional payment arising from delays during the performance of services provided that the delays are not attributable to the default of the designer; and
- the right to terminate the consultancy agreement in accordance with the agreed terms of the construction contract.

Relationships Between the Designer and Other Parties

Under a build-only contract, the design is carried out by the architect or engineer on behalf of the employer. Under a design-and-build contract, contractors sometimes engage an independent consultant or engineer to fulfil their design obligations to the employer.

A typical consultancy agreement generally requires the consultant to comply with the instructions of the employer or contractor (as the case may be).

Relationships between the consultant and the subconsultants are typically governed by the relevant subconsultancy agreement between the

consultant and the subconsultants. The subconsultancy agreement very often will require the subconsultant to conform with the requirements of the consultancy agreement and that payment to the subconsultant is contingent upon payment to the consultant by the employer.

3. Works

3.1 Scope

The scope of works in a construction contract is typically set out in the general and technical specifications and the relevant drawings (or the employer's requirement for a design-and-build contract) forming part of the construction contracts, and as amended and supplemented by the architect/engineer appointed by the employer.

3.2 Variations

Scope for Variations

The scope for variations is typically determined by the instructions or confirmation of oral instructions issued by the employer and/or the architect. By way of example, the Standard Form of Building Contracts published by the Hong Kong Institute of Architects and the Hong Kong Institute of Surveyors (2005 edition) ("HKIA/HKIS Standard Form 2005") provides that the instruction requiring a variation must describe the change required to the design, quality or quantity of the works or the imposition of (or change to) any obligation or restriction on the contractor.

Price for Variations

The price of variations is typically determined by reference to agreed contractual rates and in the absence of such agreed rates at fair rates or daywork. For instance, the HKIA/HKIS Standard Form 2005 provides that:

- additional work that can be properly valued by measurement or work that is the subject of provisional quantities, provisional items or provisional sums shall be valued:
 - (a) according to the contract bills with fair adjustment for difference in conditions or quantity for work in same or similar nature; or
 - (b) at fair value if the work is not the same as or similar in character;
- additional work that cannot be properly measured and valued may – with prior consent of the architect – be carried out as day-work and valued at prime cost, comprising labour, materials, goods, plant and equipment plus overheads and profits; and
- omissions shall be valued according to the contract bills plus fair adjustment if the contractor has reasonably incurred expenses.

Variations Requested by Contractors

The construction contract would typically provide that the contractor shall not carry out work involving a variation without a written instruction from the architect/the employer or confirmation of an oral instruction except in the event of emergency.

3.3 Design

Depending on whether the contract between the employer and the contractor is a design-and-build contract or a build-only contract, the division of design responsibilities among the employer, the architect/designer, the contractor and other consultants will vary depending on the terms of the relevant construction contract and consultancy agreements.

In a design-and-build contract, the contractor's design obligation is usually more extensive and the contractor will be required to ensure that the design and works are reasonably fit for pur-

pose. By contrast, for a build-only contract, the contractor is usually only required to follow the instructions of the employer, architect/designer or other consultants on the design and its design responsibilities may be limited to designing the temporary structures, preparing shop drawings and co-ordinating works.

3.4 Construction

The Employer, the Architect and the Authorized Person

The employer usually enters into a contract with an architect/engineer to plan and design a project and to co-ordinate with the contractor and other consultants such as the designers, engineers and surveyors. The architect/engineer often plays an important role in the administration of a construction project, with the responsibility to issue instructions/variations/certificates for and on behalf of clients/employers and for inspection and acceptance of work, etc.

An “authorized person” who is an experienced building professional registered under the Buildings Ordinance (Cap 123) has to be appointed for submission of the building proposals to the Building Authority for approval. The appointed “authorized person” is responsible for supervising the carrying out of the building works and notifying the Building Authority for any contravention by the approved plan of any building regulations.

The Contractor and Subcontractors

The main contractor is usually responsible for completing and delivering the works according to the contractual requirement and co-ordinating the work of subcontractors to ensure satisfactory and timely completion of the works. The subcontractors are responsible for completing and delivering the subcontract works according to the subcontracts with the main contractor.

3.5 Site

The responsibilities for the status of the construction site are generally determined contractually by the parties.

The risk of unforeseen ground conditions is usually borne by the contractor. By way of example, the Hong Kong Government’s General Conditions of Contract for Civil Engineering Works provides that the contractor is deemed to have examined and inspected the site and its surroundings and to have satisfied themselves – before submitting the tender – with regard to the roads or other means of access to the site, the nature of the ground and subsoil, the form and nature of the site, the risk of injury or damage to property, the nature of materials to be excavated, etc.

Most standard form contracts also provide that the contractor is responsible for complying with statutory requirements, including the relevant legislation regarding pollution.

Archaeological finds and discoveries of antiquities are, however, usually considered as events that are the fault/responsibility of neither of the parties and may be a ground for the contractor to apply for extension of time (eg, the HKIA/HKIS Standard Form 2005).

3.6 Permits

Prior approval and consent from the Building Authority are generally required for construction projects in Hong Kong, subject to certain exceptions provided under the Buildings Ordinance (Cap 123) and other legislations. Other approvals may also be needed from other government departments depending on the nature of the construction works – for example, from the Fire Services Department, the Water Supplies Department, the Drainage Services Depart-

ment, and the Electrical and Mechanical Services Department.

The “authorized person” is responsible under the Buildings Ordinance (Cap 123) for submitting the building proposal to the Building Authority for approval. The construction contract usually also provides that the contractor must co-operate with and assist the employer in obtaining all necessary permits for the project.

3.7 Maintenance

The contractor is typically responsible for the care and maintenance of the works during the construction period and until the end of the agreed defects liability period. Upon completion and the end of defects liability period, maintenance works are typically governed by separate maintenance contracts and/or warranties.

The landlords or building owners have duties to maintain their properties under legislation and common law. The duty for maintenance may also be found in the deed of mutual covenant, the Building Management Ordinance (Cap 344) and other legislation for fire, water, electrical and other utilities installations.

3.8 Other Functions

Employers in Hong Kong do not usually intervene with the operation and finances of their contractors or consultants but construction contracts in Hong Kong typically contain express clauses prohibiting transfer or assignment of building. Employers may require contractors to submit a valid business registration certificate and financial statements at tender stage.

3.9 Tests

All new buildings are required to obtain an occupation permit (OP) before completion.

To obtain an OP, the registered building contractor has to submit to the “authorized person” for endorsement a completed and signed form to certify that the building has been constructed in accordance with the Buildings Ordinance (Cap 123) and the drawings and plans have been approved by the Building Authority. Inspections will be arranged and the Building Authority will decide if an OP can be issued and, if not, what work has to be done before it can be issued.

The tests required for certified completion of the works are determined by the terms of the construction contract. Typically, the contractor is required to provide all vouchers, test certificates or other evidence to satisfy the employer/architect that the materials and goods comply with the contract specifications and to carry out all tests and inspections specified in the construction contract or instructed by the employer/architect to satisfy the employer/architect that the works have been practically/substantially completed.

3.10 Completion, Takeover and Delivery

Practical completion means that the works are fully completed to a state that permits the employer to enter into full beneficial occupation save for very minor items of work left incomplete. Substantial completion is completion to a state that permits the employer to enter into functional or operational occupation save for minor outstanding works to be completed in the maintenance period.

The architect/engineer will certify for practical/substantial completion if they believe that the works can be considered practically/substantially complete, which permits the employer to take possession of the works and marks the beginning of the defects liability period. The contractor is then considered to have delivered

the works and its liability to pay for liquidated damages for late completion may cease.

3.11 Defects and Defects Liability Period Length of Defects Liability Period

The length of the defects liability period depends on, and is generally agreed upon, in the terms of the construction contract between the employer and the contractor. The defects liability period usually ends in 12 to 24 months after substantial completion of the project (or a relevant part). For the HKIA/HKIS Standard Form 2005, the defects liability period will be 12 months from substantial completion if it is not agreed and stated otherwise in the appendix.

Remedies for Defects During Construction

If defective work or design is discovered before practical/substantial completion, the construction contract may provide the right for the employer/architect to order further testing and inspection, to direct removal or replacement of the defective work or design, to vary the work or to engage a third party to rectify the defective work or design and make an adjustment/set-off to the contract price.

Remedies for Defects After Practical Completion

After practical/substantial completion, the contractor is required to rectify the defects, which are usually listed in the defect list that accompanies the certificate of practical/substantial completion, and the employer is usually entitled to call for the contractor to return to the site to repair or to make good defects that were discovered during the defects liability period.

The employer is entitled to claim for the cost of making good and repair for defects in the works or in the design, as well as consequential dam-

ages such as compensation for loss of use or liabilities incurred towards third parties.

Remedies for Defects After Final Certificates

Most standard form contracts provide that the architect/engineer will issue the defects rectification certificate or making-good certificate upon the expiry of the defects liability period when they are satisfied that the contractor has satisfactorily completed all unfinished works and all defects have been rectified.

The architect/engineer will typically be required to issue the final certificate after the issuance of the defects rectification/making-good certificates and the signed final account. The final certificate will generally indicate that the employer has accepted and is satisfied with the quality of work concerned save for latent defects or omissions not reasonably discoverable at the time of the defects rectification/making-good certificate. By way of example, the HKIA/HKIS Standard Form 2005 provides that the final certificate is conclusive evidence that the materials, goods, workmanship and work were provided or carried out to the architect's satisfaction.

The employer may therefore not be able to claim for defects or omissions after the final certificate unless they are latent defects or omissions not reasonably discoverable.

Notification of Defects

According to the Limitation Ordinance (Cap 347), the limitation period for a contractual claim founded upon a simple contract (ie, not under seal) is six years from the date of accrual of the cause of action (or 12 years if the contract was created by deed).

The limitation period in respect of a simple contractual claim for defects usually runs from the

date of practical/substantial completion of works, except for limited circumstances where the limitation period is extended (such as acknowledgment, if the action is based upon the fraud of the defendant, deliberate concealment, mistake, etc). If the employer did not commence action for defects within six years, its contractual claim for defects may be time-barred.

The limitation period for actions of tort is six years from the accrual of the cause of action but actions in respect of latent defects can be brought within three years from the date of knowledge, subject to a maximum long stop date of 15 years from the date of accrual of the cause of action.

4. Price

4.1 Contract Price

Lump Sum Contract

For this type of contract, the contractor will carry out works based on the plans, drawings and specifications for an agreed price. The agreed basis on which the agreed lump sum will be subject to adjustments – for example, due to variations instructed by the employer/architect and or fluctuations.

Measurement Contract

A measurement contract allows the interim payments and the final contract sum to be ascertained by measurement and valuation by reference to the bills of approximate quantities or a schedule of rates agreed under the contract.

Cost-Reimbursement Contract

This type of contract provides that the cost will be paid based on actual cost incurred, including for materials, labour, plants and equipment plus an agreed percentage for overheads and

profits. The contractor may be required to submit regular cost estimates and reports on cost incurred to avoid excessive and unreasonable expenditures.

4.2 Indexation

Most standard form contracts commonly used in Hong Kong provide an option for the contract sum to be adjusted upwards or downwards to take into account fluctuations in the cost of labour and materials in accordance with provisions set out in the contract. By way of example, the Hong Kong Government's General Conditions of Contract for Civil Engineering Works provides that the sum payable certified as being due shall be increased or decreased in accordance with changes in the "Index Numbers of the Costs of Labour and Materials used in Public Sector Construction Projects" compiled by the Census and Statistics Department.

The actual risk allocation in respect of price fluctuation is negotiated and agreed upon by the employer and the contractor. It will typically depend on the uncertainties of the cost of labour and materials, contract duration and the contractor's ability to assess and manage the risk. In a typical lump sum fixed-price contract, the contractor bears the entire risk of labour and material costs fluctuation, and it may mitigate this risk by including an additional premium in the tender price.

4.3 Payment

Most standard form contracts specify the timeframe for the employer to make payment to the contractor (usually upon issuance of a certificate by the architect/engineer) and provide the contractor with the right to terminate the contract if the employer fails to make payment in accordance with the contract. Some contracts may provide that the contractors are entitled to

charge interest at an agreed rate for late payment.

Interim payments or milestone payments are provided in most standard form contracts and are generally used. Advanced payments and delayed payments are less commonly seen but not unheard of.

4.4 Invoicing

Contractors are typically required to submit applications for interim and final payments along with supporting documents to the architect/engineer/quantity surveyor for assessments and certifications.

5. Time

5.1 Planning and Programme

Role of Employer, Contractor and Other Parties

The main contractor is typically responsible for co-ordinating with the subcontractors and consultants and submitting and updating a master programme, relevant method statements and shop drawings for the construction works in order to ensure timely completion of the construction work.

The architect/engineer appointed by the employer is typically responsible for monitoring the contractors' progress of work.

Planning Safeguards

In most standard form contracts, the employer is entitled to impose liquidated damages if the contractor fails to deliver its work by the completion date. Although not commonly seen, the contract may also provide an incentive bonus for early completion.

Interim payments are typically made based on the amount of work done certified by the architect. Some contracts, depending on the nature of the work, may also provide for milestones and milestone payments.

5.2 Delays

If the event of delay is one of the specified events in which extension of time can be granted by the architect/engineer under the contract, the duty to set in motion the extension of time procedures usually rests with the contractor by giving notice of delay.

The architect/engineer receiving the notice of delay is required to decide whether the delay is an event specified under the construction contract, for which the contractor is entitled to an extension of time and the overall extension of time that they consider the contractor to be entitled to.

In the event of delays caused by the contractor's own action and/or inaction (eg, failure to secure sufficient labour, material or equipment), the contractor is not entitled to extension of time or damages from the employer and the contractor should carry out delay recovery measures or otherwise risk liability for liquidated damages for delayed completion.

5.3 Remedies in the Event of Delays

Most standard form contracts also entitle the employer to terminate the contractor's employment if the contractor fails to proceed with the works regularly and diligently.

5.4 Extension of Time

Most standard form contracts commonly used in Hong Kong require the contractor to give a notice of delay to the architect/engineer, stating the cause and identifying the listed event

specified in the construction contract, the estimated length of the delay and any material circumstances as the first step in a request for an extension of time, as well as to mitigate delay to the progress of the works. The contractor is then typically required to make further submissions at specified intervals in order to give further substantiations and updates to the effect of the delaying event.

The contractor is typically required to submit such notices of delay within a certain time upon the occurrence of the event of delay. By way of example, the HKIA/HKIS Standard Form 2005 requires the contractor to submit the first notice of delay within 28 days of the commencement of an event likely to cause delay to the completion of the works and to give a second notice within 28 days of the first notices and further submissions at intervals not exceeding 28 days until the delay ceases.

Many construction contracts will further provide that it shall be a condition precedent that the notices of delay be submitted within the specified timeframe for any extension of time requests by the contractor.

5.5 Force Majeure

The term “force majeure” is used to describe situations where an unforeseeable event, generally outside the control of the parties, makes execution of the contract impossible (or almost impossible) during the contract period. However, the term has no established meaning under Hong Kong law and each force majeure clause must be examined individually based on the facts of each case and the terms of construction contract to determine its meaning.

It is possible to contractually limit or exclude certain circumstances from being qualified as force

majeure by clear wording and clear definitions of what constitutes a force majeure event.

5.6 Unforeseen Circumstances

An unforeseen circumstance or event that renders the construction contract physically or commercially impossible to perform, or that transforms the obligation to perform into one radically different than envisaged at the time of contracting, may frustrate the construction contract. However, it is a narrow doctrine and is applied strictly in limited circumstances.

Whether the construction contract has been frustrated is to be established according to common law. The consequences of frustration are set out in section 16 of the Law Amendment and Reform (Consolidation) Ordinance (Cap 23).

5.7 Disruption

Most standard form contracts commonly used in Hong Kong allow the contractor to recover loss/expense associated with disruption to the progress of works caused by certain events. By way of example, the HKIA/HKIS Standard Form 2005 allows the contractor to claim additional payment for direct loss and/or expense because the progress of the works has been or is likely to be delayed or disrupted by a listed event. In practice, it is commonly divided into two heads of claim – namely, disruption claims (eg, loss of productivity and idling of labour, plant and equipment) and prolongation claims (eg, site overheads and site running costs). However, disruption has no established meaning under Hong Kong law.

The contractor is typically required to identify the contractual basis and provide substantiation to prove its entitlement. The method of assessment is normally to compare productivity of undisrupted activity with that of the disrupted activ-

ity, where they are similar in nature. The task of ascertaining the amount of a contractor's entitlement normally rests with the architect/quantity surveyor on behalf of the employer.

6. Liability

6.1 Exclusion of Liability

According to the Control of Exemption Clauses Ordinance (Cap 71) (CECO), liability for death or personal injury resulting from negligence cannot be contractually excluded or limited. The exclusion or restriction of liability for other loss or damage resulting from negligence must satisfy the requirement of reasonableness.

According to the Misrepresentation Ordinance (Cap 284), any contract term excluding or exempting liability or any remedy for misrepresentation must also satisfy the same test of reasonableness stated in the CECO.

6.2 Wilful Misconduct and Gross Negligence

The concepts of wilful misconduct and gross negligence exist in Hong Kong and the interpretation of such terms in a contract is governed by applicable case law.

6.3 Limitation of Liability

It is possible for the parties to contractually limit their liability subject to the statutory control set out in **6.1 Exclusion of Liability**. Limitation of liabilities are more commonly seen in contracts for smaller projects or for agreements between the employer and its consultants and are generally limited to the amount of the consultancy or service fees paid by the employer.

7. Risk, Insurance and Securities

7.1 Indemnities

Indemnities are common provisions used and negotiated by parties to limit risk. The most common types of indemnities found in standard form contracts are indemnities against the injury or death of any person and injury or damage to real or personal property and claims by third parties for breach of IP rights.

7.2 Guarantees

Surety Bonds

The contractor is typically required to obtain a guarantee from an insurance company or a bank approved by the employer/architect for the due performance of the construction contract under the terms of a surety bond. The surety bond is procured by the contractor by paying a premium.

The surety bond is typically an undertaking from the insurance company or bank to pay the employer up to a stated limit if the contractor fails to discharge its contractual obligations under the construction contract.

The surety bond can be:

- a conditional bond, which may require the employer to establish the default and/or the damages occasioned by the breach of the construction contract; or
- an on-demand bond, for which the employer may only be required to make a written demand to the bondsman without proof of default by the contractor.

Payment Bonds or Parent Company Guarantees

The contractor may also request for a payment bond or a parent company guarantee to guarantee that the employer will make payment accord-

ing to the terms of the construction contract, especially where the employer is a special purpose vehicle established for the purpose of the construction project only.

Similarly, the employer may also request a parent company guarantee from the contractor to guarantee performance of the construction contract if the contractor is a small subsidiary of an established contractor.

7.3 Insurance

The contractor is typically required to and will effect and maintain:

- employees' compensation insurance in accordance with the Employees' Compensation Ordinance (Cap 282) to cover liabilities arising from bodily injury to – or disease or death of – the contractor's or any subcontractors' employees; and
- contractors' all-risk insurance to cover liability in respect of personal injuries or deaths and/or injury or damage to real or personal property arising out of – or in the course of, or caused by the carrying out of – the construction works.

The designer and professional consultants are typically required to effect and maintain professional indemnity insurance for a minimum amount until a certain number of years from the date of notification of completion as stated in the consultancy agreement.

If the construction works involve the erection of a new building or the alteration of an existing building, it is common for the employer to effect and maintain insurance against the building.

7.4 Insolvency

In most standard form contracts commonly used in Hong Kong, insolvency of the employer or the contractor usually entitles the other party to terminate the construction contract. The termination clause typically gives the employer a right to enter the site and to use plant and materials left over for the completion of the works.

7.5 Risk Sharing

The NEC suite of contracts now commonly used in contracts for public works allows the employer and the contractor to share the risk of any delay caused by a "compensation event", which is an event that can affect the cost to the employer/client of the work being carried out, the time when the works will be completed, or both. Typically, they will be events that are at the employer/client's risk, including:

- an instruction or other change of the project manager or supervisor;
- a failure by the employer/client, the project manager or supervisor to take an action that the contract requires them to do; and
- a supervening event that is so unlikely that the risk of such will generally be allocated to the employer/client.

The target cost contracts of the NEC suite of contracts allow the risk to be shared between the employer and the contractor further. Under these types of contracts, the contractor gains a bonus if the actual cost is below the target cost but shares the cost if it goes above the target costs.

Other common standard form contracts typically define and specify the perceived risks and allocate responsibilities to either the employer or the contractor. The risks that are typically agreed to be shared between the employer or the contrac-

tor are usually events that are faults of neither parties (eg, force majeure or inclement weather).

8. Contract Administration and Claims

8.1 Personnel

Most standard form contracts, such as the HKIA/HKIS Standard Form 2005, require that the contractor's site management team to have appropriate qualifications, seniority and experience to properly organise, manage, plan supervise and co-ordinate the carrying out of the construction works.

Appointment of key management and technical positions may require the approval of the employer/architect and the employer/architect may be entitled to instruct the contractor to replace any incompetent personnel.

8.2 Subcontracting

The construction contract may require the contractor to obtain the employer's written consent before engaging all domestic subcontractors or for certain specialist trades of works. The contractor may also only object to the employer's nomination of subcontractor on grounds such as poor safety record, financial standing or technical competence.

8.3 Intellectual Property

The contractor is typically required to pay the cost of all royalties and licence fees for the design and the use of IP in respect of any materials, goods, plant and equipment used and to indemnify the employer against all claims for any infringement of IP rights in the contractor's design or use of materials, goods, plant and equipment.

For design-and-build contracts, the contractor may retain the IP rights of the design of the project, as well as know-how generated throughout the course of the project.

9. Remedies and Damages

9.1 Remedies

The usual remedy for breach of construction contract is an award of damage to compensate the innocent party for damage, loss or injury suffered as a result of the breach. Damages may also be awarded for losses consequential upon the breach.

Where a breach is repudiatory, the innocent party may choose to accept the repudiation and rescind the construction contract and claim for damages or to continue with the contract.

Specific performance may be available to the innocent party. However, the court will not normally grant such equitable relief where damages will adequately compensate the claimant or where the court cannot properly supervise performance.

Injunctive relief may also be available in some circumstances – for instance, for breach of confidentiality obligations, to the employer for evicting the contractor from the site upon termination of the contract, or to the contractor to restrain the employer from exercising the power to terminate, evict the contractor or call on security, etc.

Depending on the terms of the construction contract, other remedies such as suspension of work or determination of the contract upon notice may also be available.

9.2 Restricting Remedies

The standard form contracts commonly used in Hong Kong do not typically contain standard clauses limiting remedies available to a party.

9.3 Sole Remedy Clauses

Sole remedy clauses are not commonly used in construction contracts in Hong Kong.

9.4 Excluded Damages

Most standard form contracts (eg, the HKIA/HKIS Standard Form 2005) typically provide that the contractor may only claim for direct loss and expense for disruption/prolongation claims – ie, they do not include indirect or consequential loss or damages.

9.5 Retention and Suspension Rights

Retention and suspension rights are not generally contractually excluded in construction contracts in Hong Kong.

Retention Rights

The standard form construction contracts commonly used in Hong Kong usually expressly provide for the employers' rights to retain payment at the agreed percentage such that the employers may have recourse to it for payment of any amount they are entitled to under the construction contracts. There is no statutory obligation on employers to establish retention money trust accounts.

Suspension Rights

The standard form construction contracts commonly used in Hong Kong also usually expressly provide for the employers' rights to suspend the building works. However, the contractors may be entitled to extension of time and/or to determine the construction contract if the suspension has continued for a certain period of time.

9.6 Termination

The standard form construction contracts commonly used in Hong Kong usually contain an express right for both parties to terminate the contract. By way of example, the HKIA/HKIS Standard Form 2005 provides that upon serving a notice of default specifying the default and stating that notice of determination may be served if the default continues for a further 14 days, the innocent party may terminate the contract upon expiry of the prescribed time. A right to terminate also exists in common law in situations where one party has repudiated the contract by evincing an intention to no longer be bound by the agreed terms.

The typical contractual consequences of such termination include the contractor returning possession of the site to the employer, assigning all warranties and guarantees to the employer, and the employer employing other persons to complete the works. The architect will normally certify the final account amount in accordance with the contract. If a party terminates a contract, it is likely that it will seek to recover additional costs that flow from the breach of the defaulting party that led to the termination.

10. Dispute Resolution

10.1 Regular Dispute Resolution District Court

The District Court in Hong Kong has jurisdiction to hear civil disputes (including construction disputes) of a value over HKD75,000 but not more than HKD3 million. Disputes over HKD3 million should be submitted to the Hong Kong Court of First Instance.

Court of First Instance

The Construction and Arbitration List was established within the Hong Kong Court of First Instance to facilitate the disposal of cases concerning:

- civil or mechanical engineering;
- building or other construction works; and
- claims by or against engineers, architects, surveyors and other professional persons or bodies engaged in matters relating to the construction industry.

Construction disputes are typically commenced under this list – although a party or the judge in charge may request a case to be transferred in and out of the list.

10.2 Alternative Dispute Resolution

Mediation

Mediation is encouraged in all civil litigations in Hong Kong. Parties in litigation have to follow Practice Direction 31 issued by the Hong Kong Judiciary to file mediation notices, responses and certificates to the Hong Kong Court and may face cost consequences if they refuse to mediate without cause.

The Mediation Ordinance (Cap 620) provides a regulatory framework in respect of certain aspects of mediation.

Expert Determination

Some construction contracts in Hong Kong also provide a mechanism for parties to submit the disputes for determination by a third-party expert appointed by the parties.

Adjudication

In Hong Kong, construction adjudication – as it currently stands – is contractual rather than statutory. For public works, the contractual adjudication regime was introduced by the Development Bureau in 2021, which incorporates mandatory SOP provisions into all new public works contracts and subcontracts.

The CISOP Bill, once enacted as an Ordinance (which is anticipated to be in early 2025), will introduce a mandatory adjudication mechanism. The CISOP Bill will generally apply to construction contracts of value not less than HKD5 million for carrying out construction work and HKD500,000 for the supply of related goods or services, subject to certain exceptions under the legislation. The CISOP Bill requires an adjudicator to make a determination within 55 working days after the date on which the adjudicator is appointed (or a longer period agreed by the parties).

Arbitration

The standard form contracts commonly used in Hong Kong typically contain an express agreement to arbitrate disputes arising from building works. Most construction disputes in Hong Kong, including public works and larger-scale projects, are resolved by arbitration.

The principal legislation governing arbitration in Hong Kong is the Arbitration Ordinance (Cap 609). With the amendments to the Arbitration Ordinance that took effect in 2019, third-party funding in arbitration and ancillary court proceedings is now permitted in Hong Kong.

INDIA

Law and Practice

Contributed by:

Hardeep Sachdeva, Abhishek Awasthi, Ravi Bhasin and Nitin Saluja
AZB & Partners



Contents

1. General p.300

- 1.1 Governing Law p.300
- 1.2 Standard Contracts p.300

2. Parties p.301

- 2.1 The Employer p.301
- 2.2 The Contractor p.302
- 2.3 The Subcontractors p.303
- 2.4 The Financiers p.303
- 2.5 The Designer p.304

3. Works p.304

- 3.1 Scope p.304
- 3.2 Variations p.304
- 3.3 Design p.305
- 3.4 Construction p.305
- 3.5 Site p.306
- 3.6 Permits p.306
- 3.7 Maintenance p.307
- 3.8 Other Functions p.307
- 3.9 Tests p.307
- 3.10 Completion, Takeover and Delivery p.308
- 3.11 Defects and Defects Liability Period p.308

4. Price p.308

- 4.1 Contract Price p.308
- 4.2 Indexation p.309
- 4.3 Payment p.309
- 4.4 Invoicing p.309

5. Time p.310

- 5.1 Planning and Programme p.310
- 5.2 Delays p.310
- 5.3 Remedies in the Event of Delays p.310
- 5.4 Extension of Time p.310
- 5.5 Force Majeure p.311
- 5.6 Unforeseen Circumstances p.311
- 5.7 Disruption p.311

6. Liability p.311

- 6.1 Exclusion of Liability p.311
- 6.2 Wilful Misconduct and Gross Negligence p.312
- 6.3 Limitation of Liability p.312

7. Risk, Insurance and Securities p.312

- 7.1 Indemnities p.312
- 7.2 Guarantees p.312
- 7.3 Insurance p.313
- 7.4 Insolvency p.313
- 7.5 Risk Sharing p.313

8. Contract Administration and Claims p.314

- 8.1 Personnel p.314
- 8.2 Subcontracting p.314
- 8.3 Intellectual Property p.314

9. Remedies and Damages p.314

- 9.1 Remedies p.314
- 9.2 Restricting Remedies p.314
- 9.3 Sole Remedy Clauses p.314
- 9.4 Excluded Damages p.315
- 9.5 Retention and Suspension Rights p.315
- 9.6 Termination p.315

10. Dispute Resolution p.315

- 10.1 Regular Dispute Resolution p.315
- 10.2 Alternative Dispute Resolution p.316

AZB & Partners has a robust construction and real estate team with extensive expertise and in-depth knowledge of the multiple aspects and intricacies of construction law. It advises clients on the entire spectrum of construction law issues and investments in the real estate sector. Domestic and foreign financial institutions, domestic and foreign equity investors, institutional investors, corporations, sovereign wealth funds, private equity real estate fund managers and real estate fund developers trust the team to deliver efficient and resourceful solutions. The firm handles complicated disputes

in the construction and development space and advises clients on all types of construction and property matters, including those related to residential, commercial, mixed-use properties, hospitality, shopping centres, special economic zones, industrial developments, and public development. It also works closely with state governments, industry bodies and confederations on their continued efforts to bring changes to the real estate laws and development regulations. The firm has been widely recognised for its achievements in the real estate space.

Authors



Hardeep Sachdeva is a senior partner at AZB & Partners. With more than 29 years' experience, he advises Indian and international clients and is consistently rated as India's

leading corporate and M&A lawyer. Hardeep advises across several sectors, including real estate, infrastructure, retail, hospitality, healthcare, industrial parks, special economic zones, e-commerce, education, technology, infrastructure, the alcoholic beverage industry and others. He has been associated with several landmark M&A and private equity investment transactions in such sectors (particularly in real estate) and has done some pioneering work in these areas. Hardeep has authored various publications and serves on several government and industry body committees.



Abhishek Awasthi is a senior partner at AZB & Partners, with more than 17 years of experience. His practice focuses on M&A, construction and development, real estate,

warehousing, banking and finance, and private equity. Abhishek advises clients such as private equity funds, distressed assets acquisition funds, special situation funds, lenders, developers, landowners, and high net worth individuals extensively on various construction and development projects, real estate investment, joint ventures, and acquisition transactions across the real estate sector, including special economic zones, retail malls, commercial, office, warehousing, hospitality and residential throughout India. He advises clients on disputes in the construction and development space and has co-authored several publications.



Ravi Bhasin is a senior partner at AZB & Partners, with close to 15 years of experience. His practice focuses on M&A and real estate investment. Ravi has advised clients on various transactions involving equity and debt investments and joint ventures. He has vast experience in advising on commercial documentation involved in M&A transactions. Ravi has advised on various aspects of real estate transactions and acts for clients in various sectors, including e-commerce, real estate, single brand retail, multi-brand retail, the alcoholic beverage industry, manufacturing, media, financial services, IT-enabled services, and education. He has also co-authored several publications. Ravi has been a panelist/speaker on various business and legal forums.



Nitin Saluja is counsel at AZB & Partners, with close to eight years of experience. His practice focuses on real estate investments, financing and acquisitions, and construction and development projects. Nitin has been advising several clients on various construction and other real estate contracts.

AZB & Partners

Plot No A-8
Sector-4
Noida 201301
National Capital Region
Delhi
India

Tel: + 91 120 417 9999
+ 91 120 692 3700
Fax: + 91 120 417 9900
Email: hardeep.sachdeva@azbpartners.com
Web: www.azbpartners.com



AZB & PARTNERS
ADVOCATES & SOLICITORS

1. General

1.1 Governing Law

The Indian legal system bears resemblance to the English common law system, which is reliant on the value of binding case law precedents, rulings on equity, and the principles of natural justice. Despite the influence of the English common law system, the Indian legal system has also incorporated elements of civil law, such as certain investigative powers of the judiciary relating to the institution of commissions of inquiry or questioning of witnesses.

Broadly, the key legislation governing the construction market in India includes – without limitation – the following:

- [Indian Contract Act 1872](#);
- [Transfer of Property Act 1882](#);
- [Real Estate \(Regulation and Development\) Act 2016](#);
- [Registration Act 1908](#);
- [Indian Stamp Act 1899](#); and
- [Indian Easements Act 1882](#).

In addition, various other statutes – including the Civil Procedure Code 1908, Specific Relief Act 1963, and other state-specific laws and municipal laws – deal with development and zoning norms as well as conditions for obtaining development licences, completion certificates and occupation certificates in relation to such construction projects.

Foreign investments in the construction and development sector are additionally regulated by the Foreign Exchange Management Act 1999 and the rules, notifications and circulars issued thereunder, as well as those issued by India's central bank (the Reserve Bank of India).

The Real Estate (Regulation and Development) Act 2016 plays an important role in the construction market, thereby ensuring:

- protection of consumer interests;
- regulating the construction, development, sale, advertising and marketing of real estate projects in a time-bound, transparent and efficient manner; and
- creating a separate real estate regulatory authority, with state-specific and union territory-specific jurisdictions, for the adjudication of disputes between consumers and promoters of real estate projects.

1.2 Standard Contracts

The Indian construction market does not strictly adhere to any standard form of construction contract, as it is not a mandatory requirement in India and parties are free to negotiate and enter into any contract that they deem appropriate for their project, subject to the terms of contract being valid and legally permissible the same is accordance with the Indian Contract Act 1872. However, use of standard contracts helps to avoid disputes and provide a framework that is widely accepted and recognised, to the benefit of all parties involved.

Many government construction agencies use their own standard forms of contracts to meet specific departmental needs, especially for PPPs. In general, the standard form of contracts issued by the International Federation of Consulting Engineers (*Fédération Internationale des Ingénieurs-Conseils*, or FIDIC) and Central Public Works Department are also used in India.

Some of the widely used construction contracts in India include:

- build-operate-transfer contracts, wherein a contractor is responsible for the design, building and operation (during the contracted period) and then for the transferring of the project back to the employer;
- build-own-operate contracts, wherein the contractor ensures finances, builds, owns and operates the project and the employer purchases the goods and services produced by the construction project;
- build-operate-lease-transfer contracts, wherein a government entity gives a concession to a private entity for designing/building a project, owning it, leasing it to the government entity and subsequently transferring the ownership of the project to the government entity upon expiration of lease;
- design-build-operate-transfer contracts, wherein the contractor is responsible for designing, constructing, financing, and operating the project for the period of concession;
- operate-maintain-transfer contracts, wherein the contractor operates the project, ensures maintenance and provides training before handing the project to the employer;
- engineering, procurement and construction contracts, wherein the contractor is responsible for engineering and the employer is responsible for procurement of material and construction of the project; and
- joint development agreement, wherein the landowner and real estate developer collaborate for construction of a project.

In respect of further delegation of services (eg, designing, subcontracting, procurement, and consultancy), the contractor enters into contracts with the concerned vendors/subcontractors inter alia specifying the requirements in relation to the project and the consideration for performance of services.

2. Parties

2.1 The Employer Employers

The owners of the construction and development typically act as employers in a construction and development project. The owners/employers can be individuals, private and government corporations and statutory bodies.

Apart from some private real estate developers/employers, construction projects in India can also be in the form of PPPs between a government entity and a private entity, wherein the government entity issues tenders/request for proposals to provide open competition and to drive down costs, and invites bidding from interested private entities. The most common structure in such form is to incorporate a special purpose vehicle, which is a project corporation incorporated in India to carry out the project development, wherein the bidding member(s) own shares in the special purpose vehicle as specified at the time of bidding.

Some of the key government entity employers in the Indian construction market are:

- National Highways Authority of India;
- Central Public Works Department;
- Delhi Metro Rail Corporation;
- Indian Oil Corporation; and
- National Building Construction Corporation.

Rights of Employers

Broadly, an employer has the following rights under construction contracts:

- obtaining earnest money from the bidding parties;
- obtaining security in the form of a performance bank guarantee, corporate guarantee

- and/or retention guarantee from the contractor;
- indemnity, liquidated damages and levying penalties on the contractor upon occurrence of any breach, delay and/or non-performance by the contractor;
- holdback of partial fees/liability protection for a pre-agreed defects liability period;
- supervising/inspecting the progress of a project;
- ownership of IP relating to the project; and
- terminating the contract upon any breach of terms by the contractor.

Obligations of Employers

The general obligations of an employer under construction contracts are as follows:

- handover of the construction site for the contractor to commence work;
- obtaining construction-related sanctions and approvals (eg, licences and building plan approvals) from government authorities;
- adherence to the payment schedule of the contract;
- in some cases, employers are required to also engage subcontractors directly based on the recommendation of the contractor; and
- principal employer-related compliance obligations under certain labour/employment law statutes in respect of the workers engaged by the contractors.

The general relationship between an employer and contractor is on a principal-to-principal basis. In respect of any subcontractor appointed by the contractor, the subcontractor is an agent of the contractor. Further, any financier investing in (or supporting) the employer in the project typically has supervisory rights on the project, along with having security interest. The lenders have rights to appoint various supervisory consultants

such as project management consultants and to seek timely reports from them on status of the projects, any non-compliance by the employers, contractors, etc.

2.2 The Contractor Contractors

Construction contractors are typically individuals, partnerships, and companies.

Rights of Contractors

The key rights of a contractor are as follows:

- deploying machinery, equipment and material on the site;
- receiving payment from the employer in respect of the performance of services;
- right to additional costs in the event of any revision to the scope of work; and
- proposing incremental work to the employer for effective completion of the project.

Obligations of Contractors

The general obligations of a contractor under construction contracts are as follows:

- paying earnest money at the time of bidding;
- furnishing suitable bank guarantees and/or other forms of security as agreed with the employer;
- complying with the specifications and timelines as approved by the employer;
- adhering to the performance parameters as provided by the employer;
- ensuring removal of machinery, equipment and material from the site post-completion or upon expiry of the contract; and
- rectifying/replacing the defective or damaged work during defect liability period.

2.3 The Subcontractors

Subcontractors

Construction subcontractors are typically individuals, partnerships and companies. The subcontractors are appointed by the contractors in accordance with the consent/intimation requirements as agreed with the employer. In certain instances, the contractor is permitted to engage subcontractors that are pre-identified/pre-approved by the employer.

Rights of Subcontractors

The key rights of a subcontractor are as follows:

- performance of subcontracted services and receiving payment from the contractor in respect thereof;
- proposing incremental work to the contractor for effective completion of the subcontracted portion of the project; and
- disputing any unlawful/non-negotiated demands and/or breach by the contractor.

Obligations of Subcontractors

The obligations of a subcontractor under construction contracts are as follows:

- complying with the specifications and timelines as approved by the contractor and employer;
- adhering to performance parameters as provided by the contractor and employer; and
- ensuring removal of machinery, equipment and material from the site following completion or upon expiry of the subcontract.

The general relationship between a subcontractor and an employer is negligible, as the subcontractor is treated as an agent of the contractor. Since the contractor remains liable to the employer in respect of the subcontractor appointed by it, the subcontractor does not

have any right to make any direct claim to the employer.

2.4 The Financiers

Construction projects in India are commonly financed by:

- banks;
- financial institutions;
- non-banking financial companies;
- foreign institutions (eg, private equity funds or foreign portfolio investors); and
- alternative investment funds.

The project financing is generally secured by:

- hypothecation of receivables from project;
- mortgage of the land; and
- pledge of the shares of the borrowers, corporate guarantees and personal guarantees.

The following Indian laws primarily govern project lending to borrowers:

- [Banking Regulation Act 1949](#);
- [Reserve Bank of India Act 1934](#);
- [Reserve Bank of India's guidelines, master directions, notifications and circulars \(including on external commercial borrowings\)](#);
- [Foreign Exchange Management Act 1999](#);
- [Foreign Exchange Management \(Debt Instruments\) Regulations 2019](#);
- [Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002](#);
- [FDI Policy](#) issued from time to time by the Department of Industrial Policy and Promotion (DIPP); and
- [Companies Act 2013](#) and the rules provided thereunder.

Rights of Financiers

The key rights of a lender are as follows:

- supervising and receiving timely updates on the progress of the project (or part thereof) for which lending has been done;
- securing the loan (along with applicable interest) by getting a security interest created from the borrower;
- invoking security interest upon occurrence of any default and/or breach of financing documents;
- step-in rights in the project, along with the right to get any party novated and/or any right/obligation being assigned to any third party; and
- approving/consenting to any major deviation in the project and/or construction contract.

2.5 The Designer

Typically architect firms and specialised development management firms act as designers for various large-scale construction projects. The design firm remains responsible for preparing drawings, including concept drawing, schematic drawings and good for construction drawings. The design firm provides various draft drawings to the in-house teams of the employer and, once the employer agrees to the designs and drawings, the drawings are submitted to the sanctioning authorities for their approvals. The sanctioning authorities have right to scrutinise these drawings and provide their comments and revisions, then the design firm makes such revision and resubmits the same to the authorities for approval. Once the authorities are satisfied with the drawings, the authorities issues a sanction letter. The design firm is responsible for ensuring that the contractor appointed by the employer constructs the building as per the approved design.

3. Works

3.1 Scope

The scope of work in construction contracts is determined as per the requirement of the employer and the project. The scope of work inter alia comprises the following components:

- detailed overview and objective of the project;
- design and engineering requirements for the project;
- supply requirements for the equipment, machines, materials, tools, tackles, spares, commissioning spares, etc, in respect of the project along with the details in respect of the mobilisation/immobilisation thereof;
- details in respect of the desired services and utilities, transportation, storage, port clearance, customs duty payment, handling, insurances, testing, erection, pre-commissioning, commissioning, defect liabilities, training, supervision, dismantling, demolition of plant, equipment and building, etc;
- identified parameters and specifications relating to the project;
- implementation schedule and the delivery modes;
- requirements under the applicable laws;
- building by-laws;
- estimated costs for completion of the project; and
- management responsibilities of the contractor.

3.2 Variations

Construction contracts contain clauses for variations in the scope of work or contract price by way of issuance of a change order by the employer to that effect. The variation clause consists of terms related to:

- the employer's right to request a variation;

- the contractor's right to request a variation;
- the process to be followed for the issuance of change order; and
- related consequences of a change order inter alia in respect of additional costs, extension of timelines, and incremental obligations (as the case may be).

While the variation of the scope of work depends on the overall requirement/objective of the project, the variation of the contract price is contingent and subject to the commercial agreement of the parties under the construction contracts. Further, such variations are not permitted where they affect the nature of the construction contract and/or are beyond the contractor's competence. In certain cases, the parties pre-negotiate an upper capping on the maximum variation of scope of work/contract price permissible, typically ranging between 10–20% of the contract price.

Both the employer as well as contractor have respective rights to request variation of the scope of work/contract price only as per the variation clause of the contract price. Any deviation from the same, and/or any incremental variation in scope of work/contract price requested by either party remains subject to the mutual understanding and agreement of the parties to the construction contract.

3.3 Design

Typically, the employer engages a third-party service provider/architect for the design process of the project. Such third-party provider/architect prepares the concept design, detailed designs, master plans, layout plan, building plan, etc. These plans are reviewed by the employer. On the basis of these plans, structural consultants are appointed for detailed engineering studies, and for integration of all works and value

engineering. On the basis of the detailed engineering, the construction contractor commences the construction of the project.

The ownership of designs and IP rights related to the same vests with the employer.

3.4 Construction

The technical roles and responsibilities of contractors in respect of the construction varies from project to project; however, the general roles primarily remain the same. The contractor remains responsible for the construction, development and completion of the project as per the contractual arrangement in place with the employer/owners. Further, the contractors appoint the nominated/pre-approved subcontractors for subcontracting small portions of the works.

The division of responsibilities in the project depends on the objective of the project, generally comprising the following:

- employer – responsible for overseeing and supervising the construction process and the implication of the completion schedules by the contractor;
- contractor – responsible for carrying out the construction work in accordance with the construction contract documents, which include schedule, drawings, technical parameters and specifications (additionally, the contractor is accountable for overseeing the subcontractors engaged by it to ensure effective completion of such delegated portion of the project);
- subcontractors – responsible only for the specific portion of the construction work delegated to them by the contractor, within the allotted timeframe and in accordance with the terms of the construction contract; and

- other people – third parties engaged in the construction process are area-/role-specific and typically include responsibilities in respect of designing, technical advisory, supply of materials or equipment, or providing other specialised services as required.

3.5 Site

The responsibility for the status of construction site with regard to pollution, underground obstacles, geotechnical conditions and archaeological aspects is typically of the contractor and/or the project manager appointed in relation to the project, and such responsibilities are specified in the construction contract itself. However, both the employer as well as contractor remain obligated to comply with the applicable laws/guidelines as provided by the appropriate authorities from time to time, inter alia as follows:

- waste management – as per the regulations of the Ministry of Environment, Forests and Climate Change under the Environment Protection Act 1986, as well as the Wastes (Management and Transboundary Movement) Rules 2016, the Manufacture, Storage and Import of Hazardous Chemicals Rules 1989, the Construction and Demolition Waste Management Rules 2016, the E-Waste (Management) Rules 2016 and the Bio-Medical Waste Management Rules 2016, etc;
- wildlife – as per the relevant provisions of Forest (Conservation) Act 1980 and Wildlife (Protection) Act 1972;
- pollution – as per the relevant provisions of the Environment Protection Act 1986, the Water (Prevention and Control of Pollution) Act 1974 and the Air (Prevention and Control of Pollution) Act 1981; and
- archaeological – as per the relevant provisions of the Ancient Monuments and Archaeological Sites and Remains Act 1958, which

imposes obligations on the employer and the contractor to notify the relevant authorities in the event of any archaeological finds and to ensure that the construction work does not damage or destroy any historical or archaeological structures.

3.6 Permits

Permits

For every construction project, parties are required to obtain various permits (including without-limitation building plan approval as well as environment and pollution clearance) from various government departments/authorities in order to ensure that the construction is being carried out in a safe manner.

What follows is an indicative, non-exhaustive list of the permits required under construction projects (on a case-by-case basis):

- site plans and building plans for the building;
- commencement certificate for starting the construction of the building;
- structural stability certificate from a certified engineer and/or architect for the safety aspects of the building;
- “no objection” certificate from the state fire services department;
- “no objection” certificate from the Airport Authority of India;
- permission under the Forest (Conservation) Act 1980 is required for using any agricultural land for commercial purpose or using any forest land for any non-forest purposes;
- environmental clearance from the Ministry of Forest and Environment under the Environmental Impact Assessment Notification 2006 S O 1533 dated 14 September 2006;
- consent to establish and consent to operate from the respective state pollution control board under the Water (Prevention and Con-

- control of Pollution) Act 1974 and Air (Prevention and Control of Pollution) Act 1981;
- registration under various labour regulations, inter alia related to the Factories Act 1948, the State Migrant Workmen (Regulation of Employment and Condition of Service) Act 1979, the Employees' Provident Funds and Miscellaneous Provisions Act 1952, the Payment of Gratuity Act 1972, the Maternity Benefit Act 1961, and the Employee State Insurance Act 1948; and
- authorisation to store hazardous waste under the Hazardous and Other Wastes (Management and Transboundary Movement) Rules 2016.

Party Responsible for Obtaining Permits

Given that the majority of the obligations are delegated by the employer to the contractor, the responsibility for obtaining permits in respect of the projects is on the contractor. Some of the key approvals, such as building plan approvals and environment clearances, are typically obtained by the employer/owner.

3.7 Maintenance

Typically, the construction contract provides for the contractor to undertake the maintenance of the works until the completion of the works. Following the completion of the project and during the defect liability period, the contractor is required to rectify the deficiencies/defects in the construction work, including routine maintenance, preventive maintenance, and corrective maintenance.

Various contracts also include a covenant to execute an operations and maintenance contract between the employer and contractor, pursuant to which the contractor undertakes the obligation to operate/maintain the project as per the agreed terms – inter alia involving cleaning,

inspections, minor repairs on a regular basis – in order to avoid any breakdowns/failures. Such terms also include responsibility for replacing/repairing damaged/faulty components of the work.

Also, in certain instances, a specialist service provider is engaged by the employer for maintenance of mechanical, electrical or technical equipment installed in the project.

3.8 Other Functions

General Instructions

The crucial components related to the project are generally incorporated in construction contracts to avoid any unwarranted ambiguity or dispute between the parties. However, save and except the specified terms, if any other general instruction is required to be given in relation to the construction process, it is given by the employer to the contractor and consequently by the contractor to the subcontractor (as applicable). The employer/owner does appoint other contractors such as excavation contractors, mechanical, electrical and plumbing engineering contractors or façade contractors for a defined scope of works as may be agreed between the employers and respective contractors.

3.9 Tests

Given that the contractor remains the primary party responsible for the construction and completion of the works, the risks related to the work are also allocated to the contractor, including without limitation in respect of the testing of the completion of works. Such tests are required to be done within the timelines/schedule provided in the construction contract. However, in certain cases, employers retain the right to request the test of completion – with no mandatory obligation on the contractor for the same in the absence of such request.

The construction contracts consist of various testing procedures/details/parameters that must be complied with and successfully passed. Any failure in such tests usually results in the obligation of re-performing the work (at no extra cost) or other claims for damages (as agreed).

3.10 Completion, Takeover and Delivery

The construction contracts generally comprise terms related to completion, takeover and delivery of works – subject to such work being in accordance with the parameters as specified in the contract – and the parties mutually negotiate and agree to the delivery process. Further, such delivered works are also covered under the defect liability period, wherein the possession of work by the employer does not waive the contractor's liability to rectify the defective/damaged work-related aspects. Subject to the completion of the works and final testing to the satisfaction of the employer/owner, the employer/owner issues a certificate. From the date of such certificate, the defect liability period commences.

3.11 Defects and Defects Liability Period

The majority of construction contracts specify a defect liability period, wherein the employer and contractor mutually agree on the duration within which the contractor can be held liable for any defect in the work performed by it. Such period usually commences following the taking part in or complete delivery of the works by the employer. Any flaws in the design and/or work can be reported by the employer to the contractor during the defect liability period, pursuant to which the contractor is obligated to rectify the same.

The construction contracts may stipulate a notice period within which the employer is required to notify the contractor of any defects in the work. In case the employer fails to deliver the notice,

or if the defect liability period lapses, then the employer remains liable for any cost/expenditure incurred in the rectification/replacement of the defective work.

Remedies of Employer

Requiring the contractor to fix/replace the damaged work, withholding any payment of contract price, and imposing any liquidated damages and indemnities are the common remedies available to the employer during the defect liability period.

4. Price

4.1 Contract Price

Construction contracts are based on fixed-price modules on the basis of a bill of quantities provided by the employer. A fixed price for the entire project or a specified scope of work is agreed upon by the parties and all project-related costs (including, without limitation, labour, materials, equipment, and overhead expenses) are included in the contract price.

Some of the general milestones in construction contracts for payment of the contract price include the following:

- advance payment upon issuance of letter of intent;
- payment of an agreed percentage upon completion of designing;
- payment of an agreed percentage upon supply/installation of equipment on the project site;
- payment of an agreed percentage upon furnishing of performance bank guarantees to the employer;
- payment of an agreed percentage upon successful completion of test of works; and/or

- payment of an agreed percentage upon hand-over of work to the employer.

The contract price may also contain provisions for contingencies, such as variation in the scope of work or additional work. The parties remain free to mutually agree to a revised contract price based on the actual extent of work.

4.2 Indexation

Construction contracts have indexation for the cement and steel to be utilised for the project, and the prices for such materials are driven by market dynamics. The risk of increase in prices is typically on the employer.

4.3 Payment

The provisions related to payments are tailored to the specific needs and requirements of the parties as well as the project and are usually subject to dispute resolution mechanisms to ensure that any disputes related to payments can be resolved efficiently and fairly.

The various stages of payments under construction contracts are as follows.

- Mobilisation advance payment – the contractor may receive an initial payment at the commencement of work for covering the mobilisation and other pre-construction costs, whereby such amount depends on a project-by-project basis.
- Scheduled payments – the construction contracts specify a payment schedule with specific due dates for each payment to be made to the contractor by the employer, subject to fulfilment of the relevant obligations by the contractor. Any failure/delay by the employer in making such payment permits the contractor to claim interest or other compensation as per the contractual terms.

- Interim payments – the contractor may receive payments at specific stages of the project, such as after completion of a milestone or stage of work. Interim payments are linked to progress reports or other documentation and remain subject to review by the employer. A contractor may suspend its performance if such right is granted to it under the construction contract. A contractor may suspend its performance of works upon occurrence of any event, inter alia comprising delay in payment by the employer, non-fulfilment of pre-requisite contingent conditions, and force majeure.

Construction contracts also include provisions for dispute resolution, wherein the dispute is resolved between the parties by way of negotiation, mediation or subsequently arbitration.

4.4 Invoicing

The contractor issues invoices to the employer in the form and manner as agreed in the construction contracts, against which payment is made by the employer within the prescribed timelines and subject to the terms of the construction contract.

One common means of invoicing used in construction contracts is through the use of progress billing. Under this method, the contractor submits invoices to the employer at specific stages of the project on a periodic basis. These invoices are based on the percentage of work completed during the invoiced period and may be subject to review and approval by the employer before such payment is made.

Another means of invoicing used in construction contracts is through the use of milestone billing. This method is similar to progress billing, but the

invoices are tied to specific milestones or stages of the project rather than a monthly schedule.

5. Time

5.1 Planning and Programme

The development and construction of a project is governed by the development regulations, building regulations, by-laws and the respective master plan of a city or area of a state. A state government, usually, from time to time enacts and enhances its development plans for a period of five or ten years or longer periods.

Appropriate development permission or planning permission is provided by state-appointed authorities within the local laws and development regulations. Local municipal authorities in urban areas are empowered to enforce compliance, under applicable local laws, for various aspects of development and construction, including:

- permitted height of buildings;
- floor area ratio or floor space index, which provides the basis for determining the maximum permissible floor area construction;
- fire protection measures;
- water requirements; and
- general building requirements (eg, distance from ancient monuments, as well as eco-sensitive zones).

5.2 Delays

In the event of any delay in the progress of works, the contractors are usually required to notify the employer in writing (as early as possible) and seek extension of time as per the terms of the construction contract. Upon receipt of such notice by the employer, the parties take suitable steps to mitigate the delay. However, upon any delay that is due to the contractor, the

employer remains entitled to recover damages/penalties (if provided under contract) from the contractors.

5.3 Remedies in the Event of Delays

Construction contracts provide remedies to the employer in the event of delays by the contractor. Such remedies may include the following:

- liquidated damages – a common remedy for delay in construction contracts whereby a pre-determined amount of damages is agreed by the parties, which the contractor is required to pay to the employer for each day of delay;
- termination – the employer has the right to terminate the contract if the contractor fails to complete the work within the timelines and the right to engage a new contractor to complete the work at the cost of the defaulting contractors;
- indemnification – the employer may seek indemnification from the contractors for all the losses due to the delay in the completion of the construction/event of default; and
- invocation of the bank guarantees – the owner/employer can invoke the bank guarantee provided by the contractor.

5.4 Extension of Time

The contractor typically requests an extension of time in writing, providing a detailed explanation of the causes of delay and the impact on the project schedule. The request for extension of time would typically be accompanied by supporting documentation, such as progress reports, delay analysis reports and any other relevant information to substantiate the request. Any extension of time is entertained only as per the provision of the contract.

The grounds on which an extension of time may be awarded include:

- variations – where changes to the scope of work or design are made by the employer, resulting in delays to the project; and/or
- force majeure – where delays are caused by events beyond the contractor's control, such as natural disasters, epidemics, or government actions.

The specific grounds on which an extension of time may be granted will depend on the terms of the contract and any applicable laws or regulations.

5.5 Force Majeure

Typically, force majeure events are defined in construction contracts. These events include war, flood, drought, fire, cyclone, earthquake, or any other calamity caused by nature affecting the regular development of the project. The parties can contractually limit the circumstances qualifying as a force majeure event. Typically, in cases of a force majeure event, the parties contractually agree on consequences for such force majeure event, which includes extension of time for performance of obligations and termination rights should the force majeure event subsist for more than the agreed period.

5.6 Unforeseen Circumstances

Unforeseen circumstances are similar to force majeure events and can be governed by both mandatory or regulatory law, as well as contractually agreed upon by the parties.

In construction contracts, force majeure clauses are often included to address unforeseen circumstances. These clauses typically identify specific events that would constitute force majeure, in addition to providing for the consequences of

such events (eg, extension of time or termination of the contract). The parties would typically agree on the definition of force majeure events and the process for invoking force majeure in the contract.

5.7 Disruption

Disruption in the provision of supplies and/or other relevant materials required for the performance of work is recognised as a ground for extension of time and/or compensation, depending upon the factual aspects related to it.

The Department of Expenditure of the Ministry of Finance (India), in a circular dated 19 February 2020, has also specified that disruption in supply chain due to COVID-19 is to be covered within the ambit of force majeure.

The burden of proving disruption is on the concerned party claiming relief under it, by way of submission to the other party of relevant documents and/or evidence in respect of such disruption.

6. Liability

6.1 Exclusion of Liability

Exclusion of liability clauses in construction contracts are deemed valid, provided they do not violate any extant law. However, there are certain liabilities that cannot be contractually excluded or limited, as they are protected by mandatory law provisions.

Some examples of such liabilities include liability for:

- fraud or wilful misconduct;
- personal injury or death, caused by the contractor's negligence or breach of duty;

- defects in construction discovered during the warranty/defect liability period; and/or
- breach of statutory obligations, such as safety regulations or environmental laws.

6.2 Wilful Misconduct and Gross Negligence

A contractor may be subjected to claims for any wilful negligence and gross misconduct. A liability for gross negligence may occur for any harm caused to any individual who could foreseeably be affected by the act of the contractor.

The doctrine of “duty of care” originates from tort law and states that anyone engaging in any activity that is potential enough to harm others must exercise reasonable care. This obligation includes all people who can reasonably be anticipated to be impacted by the demonstrations of an individual. Consequently, it applies to all construction works performed by a contractor.

Any act of wilful misconduct and gross negligence by either party entitles the other party to make claim for damages in respect of such act.

6.3 Limitation of Liability

Limitation of liability clauses in construction contracts are typically provided for and are considered valid. The liquidated damages clause built into construction contracts usually specify the contract price or a part thereof to be the upper limit that can be claimed as liquidated damages.

The contractor does not remain liable to the employer for any indirect or consequential loss or damage, including (without limitation) in respect of loss of production, loss of profit, loss of interest or any other kind of loss.

7. Risk, Insurance and Securities

7.1 Indemnities

Almost all construction contracts include a clause related to indemnity. The extent of indemnification varies depending on the specific terms of the contract.

The various matters wherein parties agree to indemnify each other inter alia include the following:

- third-party claims – to address the risk of claims from a third party, including (without limitation) claims from adjacent property owners, environmental claims or claims arising from accidents on the construction site;
- breach of contract – for breach of any representations and obligations;
- non-performance – for claims arising due to failure or breach in performance of any obligation by the parties; and/or
- delay or disruption – for claims arising due to any delays or disruptions in the construction process.

7.2 Guarantees

Under construction contracts, guarantees are typically furnished by the contractor in favour of the employer and are independent contracts between the employer and contractor, governed as per the terms of the Indian Contract Act 1972. Such guarantees include the following:

- performance bonds/performance bank guarantees – furnished in respect of the effective performance of the work by the contractor;
- corporate guarantee – furnished to the employer by the parent company of the contractor;

- mobilisation advance guarantee – furnished in respect of the mobilisation advance paid by the employer to the contractor; and/or
- retention guarantee – furnished to guarantee that the contractor will continue to fulfil its contract obligations after handover of the project until the expiry of the defects liability period or until the issuance of the completion certificate.

7.3 Insurance

Various insurances are obtained in construction projects to cover risks that may arise during the course of the completion of works.

Some of the insurances that are typically taken include:

- contractor's all risks insurance – to cover physical loss or damage to the project and other associated risks such as theft, fire, flood, earthquake and other natural calamities;
- public liability insurance – to cover third-party liability for bodily injury, property damage or any other type of loss or damage due to the construction activities;
- professional indemnity insurance – usually obtained by professionals engaged in the project, in order to cover the risk of any financial loss suffered by the employer/contractor due to their professional negligence, errors or omissions;
- employer's liability insurance – under the Employees' State Insurance Act 1948, covers the liability of the employer towards its employees for any accidental injury, illness or death arising from their employment and is usually taken by the contractor; and/or
- product liability insurance – to cover the liability of the manufacturer or supplier for any harm caused by their products.

7.4 Insolvency

Construction contracts usually comprise an insolvency event clause, stating that the employer will be entitled to terminate the contract in the event of bankruptcy or insolvency of the contractor. Further, in such cases, the employer also has the right to:

- complete the contractor's obligations itself or employ a third party at the contractor's expense;
- recover costs incurred in connection with sale/disposal and restoring the project site by the contractor; and
- claim all amounts outstanding from the contractor under the contract.

Further, in the event of the insolvency of the employer, the contractor has the right to terminate the contract and recover all its outstanding amounts due and payable under the contract.

However, owing to the enactment of the Insolvency and Bankruptcy Code 2016, the timing of invocation/calling out of an insolvency event is changing and now contracts need to account for the law, which states that there is a moratorium imposed as soon as any entity is admitted for insolvency (meaning litigation cannot be initiated/continued against such party until the time the insolvency is resolved).

7.5 Risk Sharing

As the performance of construction contracts primarily depends on the performance of obligations by the contractor, risk associated with the construction project is borne by the contractor. However, any risk relating to a defect in the employer's title to the immovable property, or authorisation to construct the project, etc, remains on the employer.

8. Contract Administration and Claims

8.1 Personnel

The personnel engaged in any construction project usually belong to the contractor group. The construction contracts typically include the following clauses in respect of the personnel:

- total number of personnel to be appointed and permitted on the construction site;
- designation, key responsibilities and liabilities of such personnel;
- reporting requirements;
- adherence to health and safety guidelines;
- dismissal/removal of the personnel; and/ or
- party responsible for the remuneration and other benefits of such personnel.

8.2 Subcontracting

The subcontractors are usually appointed by the contractor to perform part of the contractor's obligations under the construction contract. However, in most cases, it remains subject to approval of the employer. Further, in certain cases, the construction contract includes a pre-identified list of subcontractors that can be engaged by the contractor. The contractor remains responsible for ensuring the competence of the subcontractor to perform the work.

Subcontracting does not absolve the contractor from its obligations and liabilities towards the employer and project under the construction contract. Any breach by the subcontractor is considered a breach of the contractor and the employer remains entitled to make a claim for damages directly from the contractor, without being obligated to approach the subcontractor in such claim.

Similarly, the subcontractor in most cases does not have any right to make any claim for damages from the employer, and its only remedy is to make said claim to the contractor.

8.3 Intellectual Property

Construction contracts include a clause that entitles the employer to claim ownership of any IP created in relation to the project/work. The contractor and/or any third party engaged in the project do not have any proprietary and/or licensing rights over said IP.

9. Remedies and Damages

9.1 Remedies

The Indian Contract Act 1872 governs contracts in India, which includes the terms related to claims for liquidated damages in case of contractual breach by any party. In the event of a breach of contract, the relevant provisions of the Indian Contract Act 1872 specifically provide that the defaulting party is obligated to pay damages to the non-defaulting parties.

Accordingly, construction contracts typically include clauses relating to liquidated damages and indemnity for claiming damages as a remedy for breach of contract by either party.

9.2 Restricting Remedies

In construction contracts, the parties commercially negotiate the quantum of limitation of liability. However, there are certain exclusions where the restriction is not applicable, which inter alia include fraud or wilful misconduct.

9.3 Sole Remedy Clauses

Typically, these clauses are not used in construction contracts.

9.4 Excluded Damages

The parties usually exclude or limit their liability for certain types of damages, such as indirect or consequential damages, loss of profits, loss of use, or punitive damages. However, this does not limit the liability of the parties for damages arising from fraud, gross negligence or wilful misconduct.

9.5 Retention and Suspension Rights

Retention and suspension rights are commonly included in construction contracts as a means to ensure compliance with the terms of the contract and to protect the interests of both parties.

Retention clauses generally specify that the employer will retain a percentage of the payment due to the contractor from each invoice until the performance parameters have been met and final handover of the project has occurred. In some cases, such amount is retained throughout the defect liability period.

Further, suspension rights are included in the construction contracts whereby the contractor is entitled to suspend performance of works upon the occurrence of any event – for example, delay in payment by the employer, non-fulfilment of pre-requisite contingent conditions, and force majeure.

9.6 Termination

Termination Events

The legal and contractual options for termination of a construction contract may vary depending on the terms of the contract and the applicable laws. Generally, the construction contracts include the following circumstances for termination of the contract, including (without limitation):

- termination for convenience – for terminating the contract at any time, upon giving a notice

period and payment of compensation to the other party, or as per mutual agreement;

- termination for breach – for termination upon breach of any material term of the contract by either party, and the other non-defaulting party issuing notice to the defaulting party along with an opportunity to cure the breach;
- termination for insolvency – for termination upon any party becoming insolvent; and/or
- termination for force majeure – for termination upon the occurrence of any force majeure event that prevents performance of the contract for a specified duration.

Consequences of Termination

The typical legal and contractual consequences of termination include the following:

- payment of compensation by the party initiating the termination to the other party for any loss suffered as a result of the termination, unless the termination was due to a breach by the other party;
- return of property belonging to the other party;
- settlement of accounts in respect of any outstanding payments or accounts; and/or
- parties invoking the dispute resolution clause for resolving said dispute in terms thereof.

10. Dispute Resolution

10.1 Regular Dispute Resolution

Adjudication of Disputes by Courts

In India, courts have jurisdiction over construction disputes based on territorial and pecuniary limits. In construction disputes, determining the appropriate territorial jurisdiction of a court is crucial. It is determined by the place where the cause of action arises, where the construction contract was entered into, or where the project/

property is situated. In addition, parties may agree to exclusive jurisdiction clauses in their construction contracts, designating a particular court or jurisdiction to hear any disputes arising from the construction contract.

However, construction contracts are usually negotiated in a manner that ensures that the resolution of any dispute is first attempted through amicable discussion between the parties – failing which, said dispute is referred to arbitration. The parties mutually negotiate the rules, seat, composition of tribunal, language, etc, in respect of such arbitration.

10.2 Alternative Dispute Resolution

In India, the prevalent ADR methods are arbitration, mediation, conciliation and negotiation. Of the foregoing, arbitration is the most popular method of resolving any contractual disputes in the construction market, wherein parties have the right to approach civil courts for any interim relief.

If the contracting parties are Indian and the project is based in India, ad hoc arbitration under the Indian Arbitration and Conciliation Act 1996 is often chosen, which recognises resolution of disputes through the methods of arbitration, conciliation and mediation. Where foreign parties are involved, then parties prefer an institutionalised arbitration.

Some of the commonly used foreign arbitration institutions are:

- the Singapore International Arbitration Centre;
- the LCIA; and
- the ICC.

Some of the commonly used Indian arbitration institutions are:

- the Delhi International Arbitration Centre; and
- the Mumbai Centre for International Arbitration.

ITALY



Law and Practice

Contributed by:

Arianna Perotti and Luca Di Marco
Dardani Studio Legale

Contents

1. General p.320

- 1.1 Governing Law p.320
- 1.2 Standard Contracts p.320

2. Parties p.320

- 2.1 The Employer p.320
- 2.2 The Contractor p.321
- 2.3 The Subcontractors p.321
- 2.4 The Financiers p.322
- 2.5 The Designer p.322

3. Works p.322

- 3.1 Scope p.322
- 3.2 Variations p.322
- 3.3 Design p.323
- 3.4 Construction p.323
- 3.5 Site p.323
- 3.6 Permits p.323
- 3.7 Maintenance p.324
- 3.8 Other Functions p.324
- 3.9 Tests p.324
- 3.10 Completion, Takeover and Delivery p.324
- 3.11 Defects and Defects Liability Period p.324

4. Price p.325

- 4.1 Contract Price p.325
- 4.2 Indexation p.325
- 4.3 Payment p.325
- 4.4 Invoicing p.326

5. Time p.326

- 5.1 Planning and Programme p.326
- 5.2 Delays p.326
- 5.3 Remedies in the Event of Delays p.327
- 5.4 Extension of Time p.327
- 5.5 Force Majeure p.327
- 5.6 Unforeseen Circumstances p.328
- 5.7 Disruption p.328

6. Liability p.328

- 6.1 Exclusion of Liability p.328
- 6.2 Wilful Misconduct and Gross Negligence p.328
- 6.3 Limitation of Liability p.328

7. Risk, Insurance and Securities p.329

- 7.1 Indemnities p.329
- 7.2 Guarantees p.329
- 7.3 Insurance p.329
- 7.4 Insolvency p.330
- 7.5 Risk Sharing p.330

8. Contract Administration and Claims p.330

- 8.1 Personnel p.330
- 8.2 Subcontracting p.330
- 8.3 Intellectual Property p.331

9. Remedies and Damages p.331

- 9.1 Remedies p.331
- 9.2 Restricting Remedies p.331
- 9.3 Sole Remedy Clauses p.332
- 9.4 Excluded Damages p.332
- 9.5 Retention and Suspension Rights p.332
- 9.6 Termination p.332

10. Dispute Resolution p.333

- 10.1 Regular Dispute Resolution p.333
- 10.2 Alternative Dispute Resolution p.333

Dardani Studio Legale is an international boutique law firm based in Genoa and Milan, with a team of advocates specialised in maritime, international trade and construction law, dealing with a broad range of shipping, commercial, corporate and construction matters. The construction and engineering team at Dardani Studio Legale assists clients in all projects and construction areas, and particularly in ship-building,

offshore, onshore and submarine construction projects, as well as in various industries such as oil and gas, power generation, renewable energies, metals and industrial automation projects. 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.

Authors



Arianna Perotti joined Dardani Studio Legale in 2019, where she deals with international commercial contracts, business transactions, construction contracts, engineering,

procurement and construction (EPC) contracts and operation and maintenance (O&M) contracts (mainly in the fields of traditional and renewable energies, onshore and offshore, oil and gas, metals and industrial automation), international sale of goods contracts, and related dispute resolution and litigation. She has more than 15 years of both in-house and private experience of advising clients in industrial property law, commercial and construction law. Arianna is a member of the Milan Bar and of the International Bar Association (IBA) and she is the secretary of the IBA's International Construction Projects Committee.



Luca Di Marco has been a partner at Dardani Studio Legale since 2014 and has 20 years' experience in shipping and construction law. He advises on ship-building, yacht and mega-

yacht refits, and construction contracts and disputes. Luca provides legal support to clients such as leading national and international manufacturing, project and engineering companies, ship-building yards, ship-owners, professional consultants, contractors and subcontractors, with a particular focus on the infrastructure, logistics, transport and energy sectors. He has comprehensive litigation experience and assists and advises clients in all phases of a project. Luca is regularly instructed by a range of foreign lawyers and has been a member of the Genoa Bar since 2003.

Dardani Studio Legale

Milan office:
Via Delio Tessa 1
20121
Milan
Italy

Genoa office:
Salita di Santa Caterina 10/8A
16123
Genoa
Italy

Tel: +39 02 365 93 170
Fax: +39 010 595 7705
Email: info@dardani.it
Web: www.dardani.it

DARDANI
STUDIO LEGALE

1. General

1.1 Governing Law

The principal source of law governing private construction is the Civil Code (Articles 1655 et seq). Public construction is specifically regulated by the Public Construction Code.

Additional laws and regulations apply depending on the object of the construction. By way of example, the Unified Building Act (*Testo Unico dell'Edilizia*) and the Town Planning Law (*Legge Urbanistica*) only apply to the construction of buildings.

1.2 Standard Contracts

Different standard forms of domestic construction contract can be found and adopted but there is neither a prevailing nor a mandatory one. Standard contract forms/templates are published by different entities, such as Chambers of Commerce or professional associations.

International standard forms, such as FIDIC (*Fédération Internationale des Ingénieurs-Conseils*, or International Federation of Consulting Engineers) or NEC (New Engineering Contract), are not common in the domestic construction context. However, their adoption is more widespread – even if subject to extensive negotiations – in international construction projects, where the contract template is usually proposed by the financiers or by the employers.

2. Parties

2.1 The Employer

The Italian construction market features different types of employers, represented mainly by institutional investors, real estate funds, private owners/developers/investors and public entities.

The main rights and obligations of the employer are determined by the underlying contract and by the applicable laws. By way of great simplification, the employer's primary obligation is the

payment of the price in accordance with the contractually established payment milestones. Additional key obligations are the grant of site access and, upon completion of the works, their verification and acceptance. In exchange, the employer has the right to receive the construction duly executed in accordance with the contract within the agreed delivery date, and request the remedy of defects and variations in accordance with the underlying contract.

In private construction projects, the different players usually enter into separate contracts, such as:

- the finance contract between the employer and its financier, with relevant securities;
- the construction contract between the employer and the contractor;
- the subcontracts between contractors and subcontractors; and
- the design contract between the architect firm or the engineering company and the employer.

Direct agreements, multiparty agreements or accession agreements are not widespread in Italian private construction projects. However, direct agreements between the contractor and the financiers are used in project finance where usually certain contractual warranties or undertakings of the contractor vis-à-vis the employer are assigned and/or transferred by the employer to its financiers (to secure the lenders' interests).

2.2 The Contractor

Different types of companies act as contractors, depending on the size and the specifics of the construction project.

The rights and obligations of the contractor in a construction project are determined by the

contract, by the Civil Code and by the other applicable laws depending on the object of the construction. By way of great simplification, the main obligations of contractors are:

- the performance and completion of the construction works within the delivery date in full compliance with the contract and the project specifications;
- the delivery of the contractual documents; and
- the remedy of any defect in the works.

In return, the contractor has the right to receive the payment of the contract price as per the contractual instalments and to obtain the acceptance of works provided that, upon completion, they are compliant with the contractual provisions.

For more on the general relationship between the contractor, the employer, the subcontractors and the financiers, see **2.1 The Employer**.

2.3 The Subcontractors

In Italy, subcontractors are typically rather small companies specialised in a particular field. Usually, the contractual relation with the subcontractors is held by the general contractor and not by the employer or the financiers.

The employer is not liable to pay a subcontractor directly. However, pursuant to Article 29, paragraph 2 of Legislative Decree No 276/2003, the employer is jointly liable with the contractor and with the subcontractor for the payment of any salary and/or social security contributions of the subcontractor's employees for the period of performance of the works.

This liability is subject to a time bar of two years from the completion of the relevant works.

2.4 The Financiers

Private construction projects are financed mainly by banks or real estate funds whereby the employer takes out a loan with the respective bank and undertakes to repay it in instalments by means of mortgage interest. Direct agreements, step-in rights or other rights vis-à-vis the contractors or subcontractors are used in major energy and industrial plant projects but are not common in the other industries.

Public works are mainly financed by the government, by local institutions, by the EU or by public private partnerships.

2.5 The Designer

Depending on the object of the construction, architectural firms and/or engineering companies are normally appointed to carry out the project design. In the industrial and energy field, it is also common that the contractor takes care of the design of the project (engineering, procurement and construction (EPC) contractor).

The relation between the designer and the employer is regulated by a design agreement from which contractual liability arises. The designer's obligation is of result and shall be performed with diligence (see 3.3 Design).

The designer always maintains the moral rights over its project, even if the design of the project is the scope of the design agreement.

3. Works

3.1 Scope

The scope of the works is an essential element of the construction contract.

Generally, the scope of works is briefly identified in the body of the contract and it is detailed in one or more contractual attachments, which usually consist of the following documents:

- design documents (drawings, engineering studies, etc);
- employer's requirements;
- technical specifications;
- bill of quantities, bill of materials and components with relevant specifications; and
- technical standards and regulations applicable to the works.

The level of detail of the scope of works depends on the type of construction contract.

3.2 Variations

According to Article 1661 of the Civil Code, the employer is entitled to order variations not exceeding one-sixth of the contract price provided that, in this case, the contractor is entitled to compensation for the additional works performed. However, a written agreement signed by the parties is required, if the variation – despite not exceeding the above-mentioned limit – materially alters the nature of the work or the extent of a specific activity. 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.

According to Article 1659 of the Civil Code, the contractor cannot vary the works, unless the variation is agreed by the employer in writing. In such a case, if the contract is a lump sum contract, the contractor is not entitled to additional compensation for the variation proposed – unless a different agreement between the parties is reached. This provision is normally mitigated in construction contracts by the inclusion of the

contractor's right to additional compensation to be calculated on the basis of the prices indicated in the contractual bill of quantities/schedule of values for similar works or on the average construction rates applicable in the market of reference for similar works.

3.3 Design

It is common that the designer is appointed directly by the employer through the execution of a designing agreement. The designer is subject to contractual liability and shall perform their obligations with diligence, to be assessed with reference to the nature of the performed activity in accordance with Article 1176 of the 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 of the Civil Code.

3.4 Construction

Depending on the peculiarities of the project, different contractual schemes can be adopted. In fact, the employer may decide to appoint:

- a general contractor, which bears the risk of the entire construction including the selection, the management, and the co-ordination of all subcontractors and suppliers;
- a main contractor, which performs the main portion of the construction managing its own subcontractors and supplier in co-ordination with other contractors appointed by the employer;
- various main contractors performing different portions of the project (such as the mechanical part, the electrical part, etc), each managing its own subcontractors; or
- different individual contractors with a highly fragmented risk allocation.

Contracts that place both design and construction obligations upon the contractor are primarily realised through the form of integrated design-build contracts or EPC contracts, mainly used in the field of industrial and energy plants.

Co-operation between different contractors (especially for participation in tenders) is achieved either:

- through joint venture agreements, with the establishment of a joint venture corporate entity; or
- more commonly, by concluding co-operation contracts (typically consortiums or *associazione temporanea di imprese*).

3.5 Site

The employer is typically responsible for the status of the construction site. Article 1664 of the Civil Code provides that if – during the execution of the project – geological, hydrological or similar difficulties arise, which were not foreseen by the parties and which make the performance of the contract considerably more onerous for the contractor, the contractor is entitled to receive an equitable indemnification in connection therewith.

This provision is usually extensively negotiated, depending on the peculiarities of the project and in consideration of which party takes the responsibility for carrying out the ground/underground surveys.

3.6 Permits

The permits required for a construction project depend on the object of the construction. By way of example, the permit that typically must be obtained by the employer for the realisation of major renewable power plants is the unified authorisation (*autorizzazione unica*), whereas the

permit that typically must be obtained by the employer for buildings construction is the building permit (*permesso di costruire*).

The construction contract typically regulates the allocation of risk for the obtainment of the different main permits.

3.7 Maintenance

The Civil Code does not include specific maintenance provisions and the general rule is that – after the project delivery and takeover – the employer (or the owner of the construction, in case it is a different entity) shall take care of the maintenance of the construction, being for this purpose free to appoint any contractor of its choice.

However, in certain types of construction (such as of industrial plants), it is common that contractor is appointed to carry out the maintenance of the plant and often the contractors agree to extend the defect liability period only in the event of subscription of a maintenance order.

3.8 Other Functions

It is not common to delegate other functions to the contractor in addition to those already described. However, in renewable energies projects, it is common that the employer and contractor also enter into a separate operation and maintenance (O&M) contract to operate and maintain the project works.

3.9 Tests

Tests for completion of the works are usually identified in the contract and must be performed by the contractor, which bears the responsibility for the testing process. Usually, the employer is entitled to participate in the tests.

3.10 Completion, Takeover and Delivery

Upon completion of the works, the employer has the right pursuant to Article 1665 of the Civil Code to perform the final inspection of the works before receiving their delivery. To this purpose, the contractor shall invite the employer to inspect and verify the completed works. In the event that, after such invitation, the employer fails – without reasons – to carry out the final inspection or to communicate its outcome within a reasonably short period of time, the works are deemed accepted. In the event that the employer accepts the delivery of the works, without reservation, the works are deemed accepted.

It must, however, be highlighted that it is common contractual practice to waive (or at least mitigate) the “deemed acceptance” principle and to precisely detail the requirements to achieve the completion, takeover and delivery of the works.

3.11 Defects and Defects Liability Period

Pursuant to Article 1667 of the Civil Code, the contractor is responsible for the defects and the non-compliance of the works, unless the employer has accepted the works and the defects were known or easily recognisable to the employer. The contractor is responsible in case of hidden defects.

After the completion of the works, the employer shall notify to the contractor any defect found within 60 days from the discovery and the respective legal proceedings must be commenced within two years from completion of the works. The notification of a defect is not necessary in the event that the contractor recognised or has hidden the defect.

The employer is entitled, pursuant to Article 1668 of the Civil Code, to request the contractor

to repair the defect or to obtain a price reduction – in addition to the reimbursement of damages – if the contractor's fault is proven. However, in the case of substantial defects that make the work completely unfit for the contractually intended purpose, the employer is entitled to termination.

The remedies set forth by law can be excluded or limited, except in the case of gross negligence and wilful misconduct. Therefore, the defect liability clause is usually extensively negotiated between the parties.

With reference to the construction of buildings or other real estate, Article 1669 of the Civil Code provides for the statutory ten-year liability of the contractor in the case of collapse, risk 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 that 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. Price

4.1 Contract Price

The contract price is usually established following two different methods, which are foreseen by Article 1657 of the Civil Code:

- lump sum basis, where the contract price is fixed and firm and the contractor thereby assumes the risk of improper evaluation of the works to be done; or
- time-spent basis or unit-price basis (so-called *appalto a misura*), whereby the employer pays the contractor on the basis of the works actually performed by the contractor.

The contractual payment schedule on a “milestone” basis is very common and usually is based on the (monthly/bi-monthly) progress of the works, as certified by the project manager/director of the works (see 4.4 Invoicing and 9.5 Retention and Suspension Rights).

4.2 Indexation

Indexation of prices is used in construction projects.

The risk of unexpected excessive price fluctuations is specifically addressed in Article 1664 of the Civil Code, which allows a price adjustment if – as a result of unforeseeable circumstances – an increase or decrease in the cost of the materials or labour causes an increase or decrease of more than one-tenth of the total price agreed upon.

This rule of law can be waived by the parties and this is quite common. However, the drastic market price fluctuations experienced in the past few years (as a consequence of the pandemic and the Ukraine war) made the inclusion of automatic price adjustment clauses more common than was the case previously.

4.3 Payment

The prevention of late payments usually is achieved by the inclusion in the contract of a payment schedule that takes into consideration the progress of the works (so-called *pagamento a stato avanzamento lavori*).

If the employer fails to honour its payment obligations on time, the contractor has the right to suspend the performance of the works pursuant to Article 1460 of the Civil Code (see 9.5 Retention and Suspension Rights). This rule is quite often invoked by contractors in order to avoid the delivery of the promised works where there

has been a failure by the employer to pay the relevant price instalments. In addition, the creditor is entitled to receive interest (the rate of which can be either agreed between the parties or can be the one established by law).

In construction contracts, it is typical that the contractor receives an advance payment (usually the 10%) of the contract price; subsequent interim payments are based on the monthly or bi-monthly progress of the works certified by the project manager/director of the works and the employer or on the achievement of contractually established milestones.

4.4 Invoicing

Pursuant to Article 1665 of the Civil Code, the parties are free to determine the payment schedule in the contractual agreement. Invoices shall be issued by the contractor accordingly. The wire transfer is the generally adopted method of payment, as the payment traceability must be ensured. In the absence of a contractual agreement, the payment schedule must be determined in accordance with customary practices. In their absence, the contractor has the right to be paid once the works are accepted by the employer. However, this last scenario is extremely rare in practice.

5. Time

5.1 Planning and Programme

Time for completion and general planning are usually agreed in the construction contract. Time for completion can either be a fixed date or a fixed number of days following the contract coming into force. The role of the parties in project planning depends on the project and usually is set up in the contract.

From a general perspective, it is typical that the employer sets up the general project timing assigning the main targets and that the contractor – through its project manager – prepares the detailed planning of the works. This scheme can, however, vary depending on the number of contractors present on site. By way of example, if the project does not feature a general contractor, the co-ordination and the general planning of the works shall be organised by the employer who usually appoints its architect or the director of the works.

Milestones and milestone payments are very common in the construction industry, as detailed in 4.1 **Contract Price**. Payment certificates are not very common and are used only in more complex and structured projects.

5.2 Delays

In the event of delays, construction contracts generally allow the employer to claim payment of delay liquidated damages, whereas the termination remedy is usually reserved for material delays exceeding thresholds predetermined in the agreement.

According to Article 1382 of the Civil Code, the parties are free to include in their contract a *clausola penale* under which, in the case of particular contractual breaches (such as late completion/delivery), liquidated damages shall be paid by the contractor to the employer. Such clause exempts 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.

In case of delay, the contractor does not bear the consequences thereof only if it is able to prove that the delay was exclusively caused by an event beyond its control (such as a force majeure event or a fault of the employer). Whenever the delay is caused by the fault of the contractor only in part, the contractor is not automatically entitled to benefit from any extension of time or to receive reimbursement of costs.

5.3 Remedies in the Event of Delays

In the event that the completion of the works is delayed by the contractor without excuses, the construction contracts typically provide the employer's right to:

- claim the adoption of extraordinary acceleration measures;
- claim delay liquidated damages up to a maximum cap set out in the contract; and
- terminate the contract when the delay penalties reach the cap contractually pre-established.

5.4 Extension of Time

Performance of the works by the contractor within the timeframe agreed upon between the parties is a key element of the construction contract; therefore, in the event of delay, the contractor is entitled to claim a time extension only if it is able to prove that the delay was exclusively caused by an event beyond its control (usually by a force majeure event or by a fault of the employer or by a third party that is not under its own liability). Extension of time shall be requested by the contractor through a written claim to the employer following the contractual requirement regarding notices, if any. The contractor shall bear the burden of evidencing and documenting the delay suffered and the underlying reasons, which shall be attributable to events outside the contractor's responsibility.

5.5 Force Majeure

Italian law does not include an exact definition of force majeure, which is usually interpreted by case law as an event of objective unpredictability and extraordinariness that renders the obligation impossible to be performed. Despite the foregoing, force majeure finds its grounds in different provisions of the Civil Code, such as:

- in Article 1218, which states that a contractual party not exactly performing his obligation, is not liable for damages if it proves that the non-performance or delay was due to impossibility of performance for a cause not attributable to it;
- in Article 1256, which provides that an obligation is extinguished when its performance becomes impossible for a cause not attributable to the obliged party; and
- in Article 1672, which provides that the construction contract is terminated if the execution of the works has become impossible owing to a cause that is not attributable to the parties.

In construction contracts, the parties are free to limit or exclude certain circumstances from being qualified as force majeure, provided that this limitation is not against mandatory rules that cannot be derogated by the parties.

It is common practice to:

- define force majeure events as events, beyond the contractor's control, that prevent the contractor from performing its obligations and that cannot be avoided nor reasonably foreseen; and
- provide that force majeure events relieve the affected party from liability and cause the extinguishment of the relevant obligation and

the termination of the contract, usually after a pre-agreed period of time.

5.6 Unforeseen Circumstances

If, during the execution of the project, geological, hydrological or similar difficulties arise that 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 therewith, according to Article 1664 of the Civil Code.

However, unforeseen circumstances clauses are usually extensively negotiated, depending on the peculiarities of the project and on which party is performing the ground/underground survey (if any).

5.7 Disruption

Disruption is acknowledged by our system as a legal ground for obtaining a time extension and the cost compensation to the extent that the contractor proves that the disruption was due to causes not attributable to him. In fact, according to Article 1218 of the Civil Code, the obliged party “who does not exactly perform [their] obligation is liable for damages, unless [they prove] that the non-performance or delay was due to impossibility of performance for a cause not attributable to [them]”.

In the case of disruption, and absence of concurrent causes of delays attributable to the contractor, the latter is usually entitled to an extension of time and payment of the additional suffered costs.

6. Liability

6.1 Exclusion of Liability

According to Article 1229 of the Civil Code, the liability for damages cannot be contractually excluded in the case of gross negligence or wilful misconduct or in the case of breach of public order rules (see 6.3 Limitation of Liability).

6.2 Wilful Misconduct and Gross Negligence

The concepts of wilful misconduct and gross negligence are specifically recalled by Article 1229 of the Civil Code (see 6.1 Exclusion of Liability). Italian law does not contain a precise definition of the two concepts, which are in any case defined and described by the case law and the authors as:

- gross negligence – the complete disregard not only for the ordinary diligence but also for the minimum levels of attention, prudence and competence necessary to perform the relevant obligation; and
- wilful misconduct – the wilful and conscious disregard for harmful, avoidable and reasonably foreseeable consequences.

6.3 Limitation of Liability

Under Italian law, the parties are free to contractually agree limitation of liability clauses. According to Article 1229 of the Civil Code, these clauses are null and void if they exclude or reduce the debtor's liability in the case of gross negligence, wilful misconduct or breach of public order rules (see 6.1 Exclusion of Liability).

Limitation of liability clauses are largely adopted and extensively negotiated between the parties. However, in cases where the contract is executed under the general terms and conditions of one party, the limitation of liability clause can be

enforced only if specifically approved in writing by the other party.

Construction contracts typically include a cap on liabilities, usually consisting of:

- the limitation of the damage compensation to an amount equal to the contract price or to a percentage thereof; and
- the exclusion of consequential and indirect damages unless they refer to people's injuries/death or are caused by gross negligence, wilful misconduct or breach of public order rules.

7. Risk, Insurance and Securities

7.1 Indemnities

Indemnities commonly granted in construction contracts for energy, industrial and infrastructure projects by the contractor to the employer are in respect of:

- personal injury to, or death of, any person arising from or caused by the performance of the works, except to the extent due to any act or neglect of the employer;
- any loss, injury or damage to any property, due to the carrying out of the works, and to the extent due to any negligence, breach of statutory duty, omission or default of the contractor; and
- infringement of IP rights.

7.2 Guarantees

Employers generally require contractors to provide guarantees to secure the proper fulfilment of their obligations. The most common guarantees requested are:

- an advance payment bond, to secure the repayment of advance payment effected to the contractor (if any);
- a performance bond, to secure proper performance of the contractual obligations by the contractor; and
- a warranty bond, to secure the fulfilment of warranty obligations by the contractor.

Bonds are usually requested to be first-demand bonds issued by banks or by insurance companies. First-demand bonds are autonomous guarantees that can be called upon simple written demand to the issuing bank/insurance.

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 that:

- are special-purpose vehicles; or
- form part of corporate groups structured in a plurality of companies.

Parent company guarantees could be also requested by contractors in case of unsatisfactory financial strength of the employer.

7.3 Insurance

The contractor must provide insurance covering its employees and workers against work accidents and occupational diseases, through the National Institute for Insurance against Accidents at Work (*Istituto Nazionale per l'Assicurazione contro gli Infortuni sul Lavoro*, or INAIL). In addition, contractors are generally requested to have:

- contractors' all-risk insurance (covering all risks connected with the works equipment and civil liability for damages caused to third parties during the execution of the works); and

- erection all-risk insurance (covering the insured against all risks that may occur during the erection and commissioning phase).

Different and additional kinds of insurance are normally requested, depending on the peculiarities of the project (such as decennial insurance, covering the risks of total or partial collapse of the building due to a defect of the construction).

7.4 Insolvency

Pursuant to Article 81 of the Italian Bankruptcy Law and Article 186 of the Insolvency Code, a construction contract is automatically terminated in the case of bankruptcy or judicial winding-up of either party, unless the receiver – after having obtained authorisation from the creditors’ committee – informs the other party of its intention to continue the contractual relationship by notice in writing to be sent within 60 days following the declaration of insolvency or following the procedure opening (as applicable) and grants adequate guarantees.

In the case of bankruptcy or judicial winding-up of the contractor, and in the event that the identity and the specific characters of the same contractor were of the essence in the employer’s decision to enter into the contract, the contract terminates upon bankruptcy of the contractor – unless the employer agrees that the contractual relationship may continue.

7.5 Risk Sharing

For detail of the division of responsibility during the construction process, please refer to **3.4 Construction**.

The allocation of contractual risks is usually negotiated between the parties and different approaches can be taken depending on the peculiarity of the project. Price contingencies

are included in the contract in order to hedge the risks assumed.

8. Contract Administration and Claims

8.1 Personnel

All the personnel employed in a construction contract must be regularly hired. The compliance with the applicable collective labour agreement and payment of all the personnel wages and taxes must be ensured.

Construction contracts typically include provisions regulating the registration of all the persons employed on the construction site, the health and safety of personnel, key persons and their replacement, unlawful employment and procedures to comply with in case of major labor accidents.

Furthermore, it is typical that contracts include specific indemnities clauses granted by the contractor in favour of the employer in case of breach of mandatory minimum wage requirements or lack of payments of personnel’s wages or taxes.

8.2 Subcontracting

According to Article 1656 of the Civil Code, subcontracting is admitted only if specifically authorised by the employer. In such a case, the contractor is entitled to enter into a subcontract agreement with the subcontractor having as its scope the performance of a portion of the works that the contractor must perform for the employer under the construction contract.

The subcontract’s provisions can be specifically negotiated or drafted on a “back-to-back” basis (which means that the rights and obligations of

the subcontractor towards the contractor are specular to those of the main contractor towards the employer).

According to Article 1670 of the Civil Code, in the event that the subcontractor's works are defective, the contractor's recourse action against the subcontractor is subject to mandatory notice to be sent by the contractor within 60 days following the notice of defects. This rule is often derogated by the parties in order to reflect the main contract provisions related to defect warranty.

As regards subcontracts, see also **2.3 The Subcontractors**.

8.3 Intellectual Property

IP of the construction design(s) is owned by its designer (who can be the contractor if under the contract the contractor is also in charge of construction design). The designer usually grants to the employer an irrevocable, royalty-free, non-exclusive licence to use such designs for the operation, repair and maintenance of the contractual works.

9. Remedies and Damages

9.1 Remedies

Under Italian law, there are several remedies available to the parties when it comes to breach of the contractual obligation.

From a general perspective, each party (employer, contractor, designer, etc) is entitled to obtain the performance of all contractual obligations by the other party. If one party breaches its contractual obligations, the other party is generally entitled to claim either specific performance or substitute performance, in addition to damages compensation. In the event of material breach,

the non-defaulting party is also entitled to terminate the contract and claim damages compensation.

The employer, in the event of defects in the works, is entitled to obtain their rectification/remedy or the reduction of the contract price and to claim damages compensation. In addition, if the defects deprive the employer of the whole benefit of the project because the works are completely unfit for the contract purposes, the employer is entitled to obtain the termination of the contract.

The contractor, in the event that an employer fails to timeously pay the contractual instalments, is entitled to suspend the performance of its obligations pursuant to Article 1460 of the Civil Code – unless, in consideration of the specific circumstances, the suspension is in breach of the good faith principle – and to claim the statutory interest. Conversely, in the absence of specific contractual provisions, the employer is entitled to suspend its payment obligations in the event of breach of contract by the contractor in accordance with the same law principle.

9.2 Restricting Remedies

It is common practice to try to limit the remedies of the parties, especially when they can adversely impact the project execution. Therefore, in construction contracts, it is common to provide for clauses allowing the contractor to suspend the performance of the works only if and to the extent that the lack of payment exceeds pre-established periods of time. In major industrial and energy construction projects, it is not uncommon that the successful rectification/remedy of defects during the defect warranty period exclude the compensation of additional damages.

9.3 Sole Remedy Clauses

Under Italian law, the parties are entitled to include sole remedy clauses in construction contracts. This kind of clause is quite common in energy, infrastructure and industrial plant projects, especially with regard to delay liquidated damages and remedy of defects.

In the case of breach of a sole remedy clause, the enforcement is subject to a court's decision (an arbitration award if an arbitration clause is included in the contract).

9.4 Excluded Damages

Italian law allows the parties to contractually exclude certain categories of damages by including a limitation clause in the contract. Even if it cannot be considered a standard practice, it is quite common that contractors try to contractually exclude any liability related to loss of profit and/or indirect or consequential damages/loss.

Damages cannot be excluded in a case where the damage is caused by wilful misconduct, gross negligence, in the event of death or personal injuries, and if the exclusion is contrary to public order provisions or fundamental rights.

9.5 Retention and Suspension Rights

Retention

The law does not provide for any automatic retention rights in favour of the employer. Retention rights are typically regulated by the parties in the construction contract and it is common for the employer to retain a certain amount (5–10% of each payment) from each milestone payment to secure the contractual performance. In general, the amounts retained are released in favour of the contractor upon the achievement of the subsequent milestone and/or after the delivery of the main material and/or after the completion and acceptance of the works. The same may

apply in respect of the expiry of the defect liability period but, in this case, issuance of a specific bond is usually preferred.

Suspension

Pursuant to Article 1460 of the Civil Code, each party may suspend performance of its obligations in the event that the other party is in breach of its own corresponding obligations. This provision can be derogated by the parties in the contract.

9.6 Termination

Termination

Each party may invoke termination of contract for a material default of the other party pursuant to Article 1454 of the Civil Code. Termination for default is subject to prior written notice to the other party containing a request to cure the default within a reasonable period, which shall be at least 15 calendar days. If the default remains unremedied, at the end of the notice period, the contract is terminated and the non-defaulting party shall be entitled to claim the damage compensation.

In addition, the parties may agree the right of automatic contractual termination in the case of breach of specific and identified contractual obligations pursuant to Article 1456 of the Civil Code. This remedy is typically foreseen in the event of excessive delay exceeding the maximum caps established in the contract or in the event of non-conformities with regard to the contractually established thresholds.

Termination under the Italian law has a retroactive effect, with exception made for contracts with continuous or periodic performance, in respect of which the effect of termination does not extend to obligations already performed. The retroactive effect does not regard the rights

acquired by third parties. However, it often happens that the retroactive effect of the termination is amended or eliminated by the parties in the contractual stipulations.

Withdrawal

Pursuant to Article 1671 of the Civil Code, the employer has the right to withdraw from a construction contract at any time and for any reason, even if the execution of works has already been commenced.

Withdrawal under Italian law does not have retroactive effect. The employer shall compensate the contractor for the incurred costs, the works already performed and loss of profit.

10. Dispute Resolution

10.1 Regular Dispute Resolution

Construction disputes are decided by court or resolved in arbitration. In Italy, there are no specialised courts dealing with private construction disputes, which are therefore subject to the jurisdiction of the ordinary courts.

10.2 Alternative Dispute Resolution

In Italy, there are different ADR methods available to the parties, mainly including arbitration, mediation and assisted negotiation.

The resolution of disputes through arbitration is commonly foreseen in construction contracts, which can either foresee institutional or non-institutional arbitration. In the first case, the rules of the relevant institution administering the arbitration apply. Conversely, in the non-institutional procedures, the underlying rules are determined by the parties and any lack is integrated by the provisions of the Code of Civil Procedure. The most important Italian arbitral institution is the Milan Chamber of Arbitration (*Camera Arbitrale di Milano*, or CAM).

A specific arbitration procedure is established by the Italian legislature under Article 213 of the Public Construction Code, in order to adjudicate disputes on subjective rights deriving from public tenders. The use of other alternative means of dispute resolution is neither widespread nor compulsory, even if the recourse to mediation procedures is slowly increasing.

JAPAN

Law and Practice

Contributed by:

Satoru Hasumoto, Fuyuki Uchitsu, Hirohiko Tanaka and Yuki Tominaga
Mori Hamada & Matsumoto



Contents

1. General p.338

- 1.1 Governing Law p.338
- 1.2 Standard Contracts p.338

2. Parties p.339

- 2.1 The Employer p.339
- 2.2 The Contractor p.340
- 2.3 The Subcontractors p.341
- 2.4 The Financiers p.341
- 2.5 The Designer p.342

3. Works p.342

- 3.1 Scope p.342
- 3.2 Variations p.343
- 3.3 Design p.343
- 3.4 Construction p.343
- 3.5 Site p.343
- 3.6 Permits p.343
- 3.7 Maintenance p.344
- 3.8 Other Functions p.344
- 3.9 Tests p.344
- 3.10 Completion, Takeover and Delivery p.345
- 3.11 Defects and Defects Liability Period p.345

4. Price p.346

- 4.1 Contract Price p.346
- 4.2 Indexation p.346
- 4.3 Payment p.346
- 4.4 Invoicing p.347

5. Time p.347

- 5.1 Planning and Programme p.347
- 5.2 Delays p.347
- 5.3 Remedies in the Event of Delays p.347
- 5.4 Extension of Time p.347
- 5.5 Force Majeure p.348
- 5.6 Unforeseen Circumstances p.348
- 5.7 Disruption p.349

6. Liability p.349

- 6.1 Exclusion of Liability p.349
- 6.2 Wilful Misconduct and Gross Negligence p.349
- 6.3 Limitation of Liability p.349

7. Risk, Insurance and Securities p.349

- 7.1 Indemnities p.349
- 7.2 Guarantees p.350
- 7.3 Insurance p.350
- 7.4 Insolvency p.350
- 7.5 Risk Sharing p.351

8. Contract Administration and Claims p.351

- 8.1 Personnel p.351
- 8.2 Subcontracting p.351
- 8.3 Intellectual Property p.352

9. Remedies and Damages p.352

- 9.1 Remedies p.352
- 9.2 Restricting Remedies p.352
- 9.3 Sole Remedy Clauses p.353
- 9.4 Excluded Damages p.353
- 9.5 Retention and Suspension Rights p.353
- 9.6 Termination p.354

10. Dispute Resolution p.354

- 10.1 Regular Dispute Resolution p.354
- 10.2 Alternative Dispute Resolution p.355

Mori Hamada & Matsumoto has a construction practice that extends from traditional construction transactions to complex construction transactions involving fund structures with a special-purpose vehicle or a trust, including investment structures for overseas investors, backed by significant experience of real estate transactions. The team's work in this practice primarily includes the following: acquisition of land for construction, advising on construction-

related agreements, structuring and fund formation for construction projects, and financing for construction. Recent highlights include advising an US-based data centre developer on the formation of a joint venture for hyperscale data centres, advising on hotel construction projects in Okinawa, Kyoto and Niseko, and advising on many other construction projects, including Urban Redevelopment Projects.

Authors



Satoru Hasumoto is a partner at Mori Hamada & Matsumoto and practises in the areas of construction and real estate. He advises data centre and hotel development projects for foreign

investors. He has considerable international experience, having advised across multiple jurisdictions, including the US, UK Australia and Singapore. His publications include "Legal Considerations Concerning Real Estate Investments in Data Centres Currently Drawing Attention" (The Finance, October 2020), "An Introduction to Real Estate Financing in the US" (ARES Journal, October 2020) and "Outline of Real Estate Investment Regarding Data Centres" (ARES Journal, December 2019).



Fuyuki Uchitsu is a partner at Mori Hamada & Matsumoto, who practises in real estate, construction, structured finance and banking. He advises on a wide range of real estate and

construction transactions, including acquisitions, developments and large-scale redevelopments. His publications include "An Overview of the Urban Redevelopment Act: Increasing Involvement of SPCs in Urban Redevelopment Projects" (ARES Journal, February 2023) and "An Introduction to Commercial Construction Loans in the US" (ARES Journal, June 2022).



Hirohiko Tanaka is a counsel at Mori Hamada & Matsumoto, whose practice areas cover construction, real estate, renewable and other energy, infrastructure and banking. His

publications include "Infrastructure Investment – System, Contract and Practice of PPP/PFI/Concession" (Nikkei BP, September 2019, co-authorship).



Yuki Tominaga is a senior associate at Mori Hamada & Matsumoto, and practices mainly in the areas of construction, real estate, project finance for infrastructure and power plant projects, PFI/PPPs, investment funds and other bespoke structured finance transactions in Japan and several Asian countries. He has broad and global experience in construction law in the areas of residential properties, hotels, logistics facilities, power plants and public facilities, among others. His publications include “International Comparative Legal Guide to: Construction & Engineering Laws and Regulations Japan” 2022 and 2023.

Mori Hamada & Matsumoto

Marunouchi Park Building
2-6-1 Marunouchi
Chiyoda-ku
Tokyo 100-8222
Japan

Tel: +81 3 6212 8330
Fax: +81 3 6212 8230
Email: mhm_info@mhm-global.com
Web: www.mhmjapan.com

MORI HAMADA & MATSUMOTO

1. General

1.1 Governing Law

The principal statutes governing the construction market in Japan include the following:

- the [Civil Code](#), which provides general rules applicable to contracts and torts;
- the [Building Standards Act](#), which provides minimum standards concerning the site, construction, equipment and use of buildings;
- the [Construction Business Act](#), which provides the rules applicable to (sub)contractors, including the necessary licence, regulations, statutory requirements for construction agreements, roles of the main contractors and subcontractors, and ADR;
- the Act on Architects and Building Engineers, which provides the rules applicable to architects, including the necessary licence, regulations and statutory requirements for design contracts; and
- the [Real Estate Brokerage Act](#), which mainly provides real estate brokerage business but also includes some restrictions on sales and other actions before the completion of construction work.

Also, residence-related laws such as the Housing Quality Assurance Act apply to residential buildings. Furthermore, contractors are required to comply with acts requiring buildings to be handicapped-accessible, environmentally friendly and earthquake-resistant.

1.2 Standard Contracts

There are some standard forms with respect to construction and design in Japan. The features of each form are as follows:

- the “General Conditions of Construction Contract” (*minkan (nanakai) rengoukyoutei*

kouji ukeoi keiyaku yakkan) published by the General Conditions of Construction Contract Committee (which is a group of seven associations and organisations) (Seven Associations GCCC) in Japanese is the form of construction-only contract used most commonly by private employers and contractors;

- the “General Conditions of Design and Supervisory Services Contract” (*yonkai rengou kyoutei kenchiku sekkei kannritou gyomui-taku keiyaku yakkan*) issued by the Research Society for General Conditions of Design and Supervisory services Contract (which is an industry organisation consisting of four associations and organisations) (Four Associations GCDS) is the form of design and supervisory services-only contract used most commonly by private employers, designers and supervisors;
- the “General Conditions of Design/Build Contract” issued by the Japan Federation of Construction Contractors is the form of design-and-build contract. In Japan, design and construction are often ordered from employers to contractors and designers separately, in which case, the Seven Associations GCCC and the Four Associations GCDS are typically used. However, in the case of D&B contract (both are ordered from the employers to one party acting as a designer and a contractor at the same time), this form can be adopted;
- for the construction of some domestic power plants, the “Model Form for Domestic Plant Construction Work” issued by the Engineering Advancement Association of Japan is used. However, a customised engineering, procurement and construction contract is often adopted for renewable energy projects;
- the “General Conditions of Public Construction Standard Contract” (*koukyou kouji hyoujyun ukeoi keiyaku yakkan*) is typically used as a standard form for projects involving public

works. Aside from government agencies and local governments, private electric power companies, railway companies and other companies that regularly order construction work also use this form; and

- recently, in some cases where offshore parties are involved in the construction project, such as offshore wind farm projects, FIDIC-based contracts may be adopted when agreed between the parties.

2. Parties

2.1 The Employer

In Japan, employers can be very large to small legal entities, including SPCs for joint venture and real estate investment, individuals, and governmental bodies. In some cases, such as housing construction, there can be multiple employers, and they jointly and severally owe obligations, including the payment of the contract fee.

General Rights and Obligations of the Employer

The rights and obligations of the employers vary, depending on the contracts, including contract templates such as the Seven Associations GCCC among private entities, the General Conditions of Public Construction Standard Contract ordered by governmental bodies, or tailor-made construction contracts negotiated for project finance. Despite the differences among the contracts, the common and typical rights and obligations of the employers include:

- the right to supervise the work and inspect the completed work by itself or an appointed third party;
- the right to request repair of defects, deliver substitutes, reduce the payment amount, or

compensate for loss or damage. Please see **3.11 Defects and Defects Liability Period**;

- the right to request additional work or a change of the work scope and timeline in exchange for an increase or decrease of the contract fee proposed by the contractor;
- the right to cease or suspend the construction work before completion by compensating for loss or damage incurred by the contractor;
- the obligation to pay the construction fee;
- the obligation to secure the land for construction work; and
- the obligation to compensate the contractor when the employer orders the construction work to cease or be suspended.

General Relationship Between the Employer and the Contractor

Employers and contractors have contractual relationships under construction agreements. These days, due to the active market and high demand for construction, contractors tend to have strong bargaining power and, in some cases, contractors do not accept any changes requested by employers from the Seven Associations GCCC or their own contract template.

General Relationship Between the Employer and the Subcontractors

Typically in Japan, the employer orders all construction work to one contractor in a lump sum, then the contractor contracts with several subcontractors. In this case, employers and subcontractors do not have any direct contractual relationships; rather, contractors have direct contractual relationships with subcontractors and owe an obligation to employers to supervise subcontractors. On the other hand, if, for example, the employer is able to manage and co-ordinate the work of several contractors, the employer may elect to directly execute an agreement with the subcontractors (eg, equipment

contractors) separately from the construction of the main building itself.

General Relationship Between the Employer and the Financiers

In order to monitor the progress of the construction, financiers request employers to submit periodical construction reports to financiers and may ask for further rights such as a separate inspection by the lenders. For project finance, because it is important for the construction of building or facilities to be properly completed, financiers tend to be actively involved in the monitoring of the construction and advocate for strong rights against the employers.

2.2 The Contractor

In Japan, contractors are required to obtain a construction licence. Under the Construction Business Act, contractors are required to obtain a permit from the Ministry of Land, Infrastructure, Transport and Tourism (MLIT) (if the construction business is conducted in two or more prefectures) or the prefectural governor (if the construction business is conducted in one prefecture only) if a certain threshold is met. This threshold includes conducting construction work for a fee of at least JPY5 million or, for large-scale and complicated construction, JPY15 million.

Usually, the contractor is a single company, but for large-scale and technically challenging works, joint ventures may be formed by several companies.

General Rights and Obligations of the Contractor

The rights and obligations of the contractors depend on the contracts agreed upon, but the common and typical rights and obligations of contractors include:

- the right to receive construction fees from the employer, including additional fees if the contractor conducts additional work;
- the right to request compensation when the employer directs it to cease or suspend construction work;
- the right to cease construction work or terminate the contract if the employer breaches certain obligations and fails to remedy the breach despite written notice from the contractor;
- the obligation to perform the agreed construction work in accordance with contractual and applicable legal requirements, within the stipulated timeline;
- the obligation to repair defects or deliver substitutes when there are any defects in the completed work;
- the obligation to purchase and maintain certain insurance for construction required under the contract;
- the obligation to compensate third parties if the construction work causes any damage to them; and
- the obligation to support the required inspection under contracts and applicable laws.

General Relationship Between the Contractors and the Subcontractors

Contractors often subcontract part of the construction work to one or more subcontractors. Thus, contractors and subcontractors have contractual relationships. Contractors, as employers under the subcontract agreements, manage and pay subcontract fees to subcontractors, and subcontractors, as contractors under the subcontract agreements, provide agreed construction work and receive a fee. Typically, in Japan, contractors are large-scale companies (some are called “super general contractors”) and have wide discretion to select subcontractors without the employers’ consent. As such, contrac-

tors tend to have bargaining power compared to subcontractors, which are middle-to-small-scale companies or individuals.

General Relationship Between the Contractors and the Financiers

Ordinarily, contractors and financiers do not have any contractual relationships. However, in project finance or real estate investment projects, financiers of the employers may require certain provisions, including limited recourse clauses from a bankability perspective, to be incorporated into the construction agreement. Also, in some project finance cases where lenders hope to have direct contractual relationships with contractors, lenders request to execute a direct agreement with the contractors.

Please see **2.1 The Employer** regarding the relationships between the contractors and the employers.

2.3 The Subcontractors

Typically, in Japan, subcontractors are middle-to-small-scale companies or individuals, and in some cases, they are required to specialise in a particular field and technique for the construction of specific facilities, including power generating plants and aquaculture facilities.

General Rights and Obligations of the Subcontractor

Generally, in Japan, contractors owe the obligation to employers to complete the entire construction work. The contractors order some part of the work, at their own discretion, to subcontractors selected by the contractors by executing an outsourcing agreement. Hence, subcontractors often have contractual relationships only with contractors and usually do not enter into any direct agreement with an employer. The rights and obligations of subcontractors depend

on the outsourcing agreements, and contractors and subcontractors tend to have their own contract templates. The relationships and bargaining power between the two parties are decisive for which template or format will be used, but in many cases, subcontractors' rights and obligations are similar to those of contractors' mentioned in **2.2 The Contractor**.

General Relationship Between the Subcontractors and the Financiers

As mentioned above, contractors commonly have rights and assume all obligations with employers and financiers, and then outsource part of the work to the subcontractors. Hence, the subcontractors rarely have direct contractual relationships with financiers.

Please see **2.1 The Employer** and **2.2 The Contractor** regarding the relationships between the subcontractors, and the employers and the contractors.

2.4 The Financiers

Banks are the main players as debt financiers in Japan. Other institutional investors such as insurance companies, leasing companies or pension funds also play important roles in the market, whether in debt or in equity.

General Rights and Obligations of the Financiers

Debt providers usually have structural or contractual priority over equity providers. In the case of construction project finance, there is usually no source of interest to be paid to the debt providers, so lenders usually seek a reserve sufficient to receive interest payments and other disbursements during the construction period. In addition, during the construction period, dividends to equity providers are generally prohibited. Debt providers in construction project finance usually

require securities over all of the major assets of the borrower (ie, the employer), including land, insurance claims and other related rights and claims. For project finance, financiers usually request security over the rights and contractual status, of the employers under the construction contracts. Both finance providers have information rights, to receive the necessary documents and information (such as financial statements).

Please see **2.1 The Employer**, **2.2 The Contractor** and **2.3 The Subcontractors** regarding the relationships between the financiers, and the employers, the contractors and the subcontractors.

2.5 The Designer

Construction companies, architectural design companies/offices and individual architects are the typical players as the designers in Japan. Under the Act on Architects and Building Engineers, designers are required to obtain licences to conduct certain design work. For instance, those who design buildings with two or more floors and a total floor area of more than 1,000 sqm are required to be licensed as a “first-class architect” by MLIT. There are also “second-class architect” and “wooden building architect” licences, with more restricted permitted scopes of work.

General Rights and Obligations of the Designer

The rights and obligations of the designer depend on the scope of the design agreement. The Four Associations GCDS, which is the most commonly used template for design agreements in Japan, includes supervisory work by the designer. The designers’ rights and obligations in this template include:

- the right to receive design and supervisory fees from the employer, including additional fees if the designer conducts additional work;
- the right to request compensation when the employer orders the design work to cease or be suspended;
- the right to cease design work if the employer breaches certain obligations or to terminate the contract by paying compensation to the employer;
- the obligation to perform the agreed design and supervisory work under the contract and applicable laws, within the stipulated timeline; and
- the obligation to revise defects or deliver substitutes when there are defects in the completed work.

General Relationship Between the Designers, and the Employer and the Contractor

Designers have a contractual relationship with the employers. Although designers, contractors and subcontractors are not always the parties to one agreement, in some cases a designer is appointed by the employer as a supervisor of the construction work. In such a case, designers, and contractors and subcontractors collaborate with each other to check if the construction work is carried out and completed in accordance with the construction plan and blueprints.

3. Works

3.1 Scope

The scope of the construction work is commercially agreed upon and attached as an exhibit to the construction contract to specify the construction work. The exhibit includes the specifications, requirements, design, floor plan, invoice and/or materials of the facilities to be constructed. The amount of the exhibits can be so volu-

minous that they are often stored in separate physical files and electronic data.

3.2 Variations

In Japan, employers may order variations of work when necessary and contractors may request a necessary variation of work if there is a reasonable ground for such request. In either case, the contractor may propose the scope and method for the change in the work as well as the amount of the increase or decrease in the construction fees. Once the employer agrees to the proposal, the scope of work and the construction price will be amended.

To the extent agreed, the timeline for the construction work can be revised concurrently and such change of schedule may be grounds for an increase of remuneration for the construction.

If an employer orders a variation and the contractor incurs a loss or damage, the employer is required to compensate the contractor for such loss or damage.

3.3 Design

The scope of work and responsibilities of the designers are often agreed upon in the design agreement, typically in the Four Associations GCDS template, which is separate from the construction contract. Therefore, the responsibility for the design process is taken by the designer, not the contractors. Generally speaking, employers are not responsible for the design work unless the employers (i) specifically direct and cause the designers to act wrongfully, or (ii) engage in any activities that are contrary to the purpose of the design agreements.

3.4 Construction

Unless employers specifically direct and cause the contractors to act wrongfully or engage in

any activities that are contrary to the purpose of the construction contract, contractors are fully responsible to the employers for the construction work, in principle, even if the cause of a defect or breach lies with the subcontractors.

Between contractors and subcontractors, subcontractors are liable for the results within the scope of the outsourced work.

A designer can be liable to the employer for overlooking construction defects if the scope of their work includes supervising the construction work.

3.5 Site

Employers must ensure that the construction site can be used by the date necessary for the work. As such, employers are, in principle, liable for the risks to the condition of the construction site. However, this risk allocation is not governed by any mandatory or regulatory law, so parties may contractually agree upon a different risk allocation.

3.6 Permits

Requirements for the Buildings

In Japan, the Building Standards Act stipulates minimum standards for the site, construction, equipment and use of buildings. Contractors and designers are responsible for the construction and design to comply with the requirements under the act.

Although this act stipulates various complicated and technical requirements, the basic points are: (i) the employer (in reality, designers act for the employer) must apply for confirmation that the designed building complies with all building regulations and receive a compliance certificate from an authorised person/entity (such confirmation being “Construction Confirma-

tion”), and (ii) after the completion of the building, the employer (in reality, contractors act for the employer) must apply for inspection by an authorised person/entity to determine whether the completed building complies with all building regulations and receive a compliance certificate from an authorised person/entity.

Technically, the employer applies for such confirmation and inspection, but designers and contractors prepare the necessary documents and take responsibility for the result. If there are any issues found in the procedure, designers and contractors are responsible for those issues and thus obligated to repair and revise the defect to pass the inspection.

Sales of the Buildings

If a seller of a (unit of) building is a “Real Estate Broker” under the Real Estate Brokerage Act (ie, an individual or entity engaged in a business in which they buy, sell, or exchange building lots or building or provide intermediary or agency services therefor with the required permit), the seller must comply with certain regulations in addition to the general requirements under the act. Such special requirements include:

- not signing a contract with a buyer before obtaining the Construction Confirmation;
- not advertising before obtaining the Construction Confirmation;
- the seller being required to explain to buyers the required additional information pursuant to the act; and
- not receiving deposits exceeding a certain threshold unless an indemnity agreement with a bank or other financial institution has been executed to protect the buyer.

3.7 Maintenance

Before the handover of the completed work, contractors are responsible for the maintenance of the works. Contractors basically assume all obligations and risks of the construction work during that period and maintenance of the works is a part of those obligations.

Once the completed work is delivered to an employer in accordance with the construction contract, the responsibility of the maintenance shall be also transferred to the employer as a property holder, with discretion on the method of the maintenance. In some cases, employers entrust the contractors or their affiliates specialised in maintaining the same type of facilities to maintain the property by executing a separate property management agreement or maintenance agreement considering that contractors already know the specifications and appropriate maintenance method.

3.8 Other Functions

It is possible for an employer to instruct the contractor on other functions, but this is not always the case and typically, contractors have discretion on every function, other than what is specifically ordered by the employer in the relevant case.

3.9 Tests

Before the full handover of the completed work, contractors are typically obligated (i) to conduct contractually agreed tests and (ii) to provide support to pass statutory inspections.

The purpose of the contractually agreed tests is to confirm that the completed work satisfies all requirements under the construction contract, which may include the specifications of facility. It is often the case, especially in the case of complex facilities such as power plants and data

centres, that the methods and passing criteria of such tests are agreed in advance when the contracts are executed.

Statutory inspections include an inspection by an authorised person/entity under the Building Standards Act to confirm whether the completed building complies with all building regulations. Please see **3.6 Permits**.

If there are any other tests required under the design and supervisory agreements, contractors are required to co-operate when these tests are conducted.

In any case, employers and their appointees have the right to be present when the tests are conducted.

3.10 Completion, Takeover and Delivery

The processes of completion, takeover, and delivery are agreed upon in the construction contract. Generally speaking, when the contractor determines that the construction work is ready for completion tests, they ask the employer to conduct the required tests and inspections, including statutory ones. If the facility passes the tests and no physical, performance and regulatory defects are found, the contractor will deliver the facility to the employer.

If the facility fails the tests or issues are found in the inspection, the contractor must repair the facility or resolve the issues until the facility passes the tests and all issues are resolved.

The employer and contractor may agree to (i) the use by the employer of part of the facility and (ii) partial delivery to the employer before the tests and inspections are completed other than those required under mandatory regulations. Such agreements are useful when full turnover

takes time and partial use and delivery generate profits for the employer.

3.11 Defects and Defects Liability Period Defect Liability Period

Under the Japanese Civil Code, the claim period for non-conformity to the contract is (i) 10 years from delivery or (ii) five years from knowledge that they can exercise their rights of the claim, whichever is earlier.

Having said that, market practice (under the Seven Associations GCCC) has modified the general rule as follows:

- contractors are liable for non-conformity to the contract (which includes defects found in a building) for two years from delivery;
- notwithstanding a) above, contractors are not liable for any non-conformity in the main parts of building equipment, interior finishings, or decorations, furniture, trees or plants or other similar items, unless the employers require the contractor to cure such non-conformity immediately after inspection at the time of delivery of the construction work; provided, however, if such non-conformity could not be discovered by the employers with due care during the inspection, the employers may make a claim within one year after the date of delivery;
- employers are required to make a claim for non-conformity under a) and b) above in a manner clearly expressing the intention to pursue the claim against the contractor for liability due to non-conformity, with the grounds for the claim and calculation of the amount claimed as damages;
- if the employer (i) discovers the non-conformity within the claim period described in a) or b) (the “Non-Conformity Liability Period”), (ii) notifies the contractor of the

non-conformity within the Non-Conformity Liability Period, and (iii) makes a claim in the manner described in c) within one year from the notification of non-conformity, such claim will be deemed to have been made within the Non-Conformity Liability Period;

- notwithstanding a) to d) above, the limitation under a) to d) above does not apply if the non-conformity was due to the wilful act or gross negligence of the contractor. In this case, the general rules under the Civil Code shall apply; and
- lastly, with respect to a construction contract for a new house prescribed in the Housing Quality Assurance Act, the defect liability period cannot be shorter than 10 years after the date of delivery. This statutory requirement is applicable to defects in certain main structural and rainwater-proof components.

If the above periods have lapsed, the employer's right to seek remedies described below will be forfeited.

Remedies Available to the Employers

If defects are found in the construction, the employer may demand for the repair of the defect, delivery of a substitute, reduction of payment, or compensation for loss or damage. These remedies are available whether the demand is made before or after the handover to the employer; provided that the demand was made within the explained defect liability period and the employer completed the described requirements and procedures.

4. Price

4.1 Contract Price

In Japan, a lump sum fixed contract price is widely adopted in the market, and a change in

price is subject to the terms and conditions stipulated in the contract (please see **3.2 Variations**) or the parties' mutual agreement.

Under the Seven Associations GCCC, immediately after the signing of the construction contract, the contractor is required to submit the breakdown of the contract price to the employer and its appointed supervisors for their review.

Milestone payments are often agreed between the employer and contractor. Typically, such payments are made (i) upon the commencement of the work, (ii) upon reaching one or more interim milestones (eg, at the time of framework raising), and (iii) upon the completion of the work. It depends on the agreement, but the last payment is typically the largest payment.

4.2 Indexation

Possible grounds to change the construction fees include unexpected changes in laws, inflation and wage increase. These are stipulated in the Seven Associations GCCC.

Though indexation provisions have been rarely used in Japan, due to the current economic status and possible future inflation, some contractors may ask to include clauses for more flexibility to change the contract price. At this time, employers are hesitating to incorporate such clauses, but the market is now fluid and attention should be given to future changes.

4.3 Payment

Milestone payment is the prevailing method for payment (please see **4.1 Contract Price**). If contractors are concerned about late or non-payment, they can request a larger ratio of the price to be paid at the commencement of the work or middle milestones.

Also, a default charge clause (typically, 10% or 14.6% per year) is a measure to deter late or non-payment.

4.4 Invoicing

In Japan, a lump sum fixed fee is widely adopted and changes to the payment amount are not unpredictable (please see **4.1 Contract Price**). For this reason, periodical invoicing is not necessary in practice.

Typically, a fee estimate issued before signing the construction contract and for variations can be the basis of a final invoice, indicating the final amount of the contract price.

5. Time

5.1 Planning and Programme

In Japan, contractors prepare an outline construction schedule, including the necessary work and time for temporary works, permanent works, tests and inspection, and estimated delivery date. These will be discussed between the employer and the contractor, and the Seven Associations GCCC requires contractors to submit the finalised construction schedule to the employer immediately after the signing of the construction contract.

5.2 Delays

It is often the case that the contractor periodically reports on the progress of the construction to the employer and, as a result, both parties can recognise possible delays before the deadlines. When the construction work is likely to be delayed, parties first discuss the necessary steps to accelerate the work and/or an extension of the timeline. Depending on the reasons for the delay, parties may agree to increase the contract fee or compensate for the delay. It is

relatively rare to terminate the contract based on non-material delays because it is detrimental to both parties to cease and abandon the construction, or look for new contractors, which are likely to cost more than maintaining the original contractor.

Reflecting this practice, an extension of time is widely accepted in construction contracts. For instance, employers may propose an extension when it is necessary without any rationale under the Seven Associations GCCC. Please see **5.4 Extension of Time** for the grounds of extension requested by contractors.

If the construction work delays due to the contractor's breach, remedies are available to the employer. Please see **5.3 Remedies in the Event of Delays**.

5.3 Remedies in the Event of Delays

In the event that construction work is delayed after the agreed deadline, the employer may terminate the construction contract or claim compensation and default charges against the contractor for loss or damage incurred. Due to the inefficiency of terminating the contract, employers tend to choose to seek compensation. Under the Seven Associations GCCC, a penalty for delay in delivery of 10% per annum on the contract price is stipulated as a liquidated damages. In project finance, the amount of liquidated damages tends to be negotiated to cover the estimated cash flow.

5.4 Extension of Time

The grounds for time extension are stipulated in construction contracts. For example, under the Seven Associations GCCC, contractors may request for a time extension in cases where:

- there is ambiguity or a discrepancy in the design, specifications, and conditions;
- the employer requests for examination by breaking and uncovering the construction to clarify any suspected non-compliance with the construction documents, but the work is found to be in compliance with such documents;
- there is damage to a third party due to the construction work, which is not attributable to the contractor;
- there is damage to the contractor due to the construction work, which is attributable to the employer;
- there is an issue found in the course of a statutory inspection, which is not attributable to the contractor, and the parties agree to take necessary steps to resolve the issue;
- the contractor agrees to partial use of the facilities, as requested by the employer, before the completion of work;
- the employers request to terminate the construction work;
- the contractors have a right to terminate the construction work under the contract; and
- there are any other reasonable grounds, including force majeure or a request for additional work or a change in the work.

There are some patterns to determine whether or not and for what period an extension of time should be granted. One way is that contractors propose the necessary time for the extension based on the agreed grounds of the time extension, and parties will discuss and agree on the necessity and period for the time extension. As the reasons for the time extension are various and depend on the situation, there is no specific criteria other than “necessity”, but excessive extensions will not be awarded.

5.5 Force Majeure

In many cases, force majeure is defined as an Act of God, or other natural or artificial cause for which neither party is responsible or is able to control. This includes natural disasters such as earthquakes, floods, and typhoon, war, terrorist attacks and riots. After the COVID-19 pandemic, some contracts include infectious disease in the definition of force majeure. There is no statutory requirement for the definition of force majeure, and the parties may contractually agree upon the scope of force majeure.

Typically, when any force majeure event occurs, contractors are entitled to ask for an extension in the construction schedule and a suspension or cessation of the work, and sometimes for an additional cost/increase of the contract price depending on negotiation.

5.6 Unforeseen Circumstances

If unforeseen circumstances fall in the definition of force majeure, the same rule for force majeure is applicable. Please see **5.5 Force Majeure** for the typical consequence.

In Japan, there is also a general legal principle of “Change of Circumstances”, which allows either party to amend or terminate an agreement under extraordinary changes in the social environment which was impossible to expect at the time when the contract was signed, so that it is unfair to enforce the original agreement. Unexpected changes in laws or extreme inflation may be a possible example, and the Seven Associations GCCC includes the provision derived from this principle as a ground to change the contract price (please see **4.2 Indexation**).

However, it is very rare in Japan for the courts to apply this legal principle. Hence, parties should not rely on this principle and its derivatives. If

any specific grounds and consequences for unforeseen circumstances are necessary, they should be clearly discussed and agreed upon by all parties.

5.7 Disruption

In Japan, disruption itself is not an individual legal concept widely accepted as a ground for extension of time or compensation. It may be one of the components of force majeure, and if a certain type of disruption falls in the definition of force majeure, the same rule for force majeure is applicable. Please see 5.5 Force Majeure.

If any specific grounds and consequences for disruption are necessary, it should be clearly discussed and agreed upon by all parties.

6. Liability

6.1 Exclusion of Liability

There are no specific mandatory law provisions in Japan that prohibit certain clauses in construction contracts or design contracts to exclude the liability of a party, other than general legal concepts.

One such general legal concept is the violation of public policy; that is, if specific terms of the contract are considered offensive to public order, such terms are unenforceable on an ad hoc basis due to the principle of public policy.

As a derivative of such a concept, under the Consumer Contract Act, if the employer is a “consumer”, and any terms of the contract restrict the consumer’s rights or expand the consumer’s obligations to the extent such terms unilaterally prejudice the interests of the consumer and violate the fundamental principle of public order, such terms are void.

6.2 Wilful Misconduct and Gross Negligence

In Japan, gross negligence is often referred to as negligence amounting to a wilful act or omission, or a significant deviation from the ordinary duty of care which a person in similar situation would owe. In legal commentary, this has been described that a person acts with gross negligence where the person could have easily foreseen and avoided the result with ordinary duty of care but has not. The analysis of the concept of “gross negligence” has developed under precedents, and mandatory or regulatory laws do not provide the details of the concept.

On the other hand, there is no separate legal concept of wilful misconduct in Japan. This concept is also discussed under “intentionally” or “with gross negligence”.

6.3 Limitation of Liability

It is possible for the parties to limit their liability under construction contracts or design contracts unless otherwise prohibited in applicable laws.

One such law is the Housing Quality Assurance Act, which prohibits limiting contractors’ defect liability period to be shorter than 10 years after the date of delivery in certain cases. Please see 3.11 Defects and Defects Liability Period when the Housing Quality Assurance Act is applicable.

7. Risk, Insurance and Securities

7.1 Indemnities

In Japan, the concept of indemnification is not common. Instead of indemnification, compensation is widely recognised as the legal concept equivalent to indemnification.

When a party breaches a contract, including non-conformity with the provisions or requirements and delay in delivery of the completed work or the payment of the construction fee, the breaching party is liable to compensate the non-breaching party for the loss or damage incurred to the extent that the breach has a causal link to such loss or damage.

In project finance, parties typically agree to incorporate the concept of liquidated damages, which is a special provision for compensation in that the amount of loss and damage are agreed to be fixed to cover the estimated cash flow when the construction schedule is delayed.

From this perspective, compensation functions to fairly allocate the risks of damages to the parties.

7.2 Guarantees

In Japan, generally speaking, it is not common to require a guarantee from private parties, especially when an employer is a company in sound financial condition.

On the other hand, in some public works, the government may require the contractor to provide a guarantee for the performance of certain construction work or other obligations. The terms and conditions of the performance bonds are determined by the government office in charge of the project, and it is usually difficult to negotiate for any change. Such performance bonds are typically in the form of a demand guarantee under the Uniform Rules for Demand Guarantees published by the International Chamber of Commerce.

7.3 Insurance

Companies, including employers and contractors, are required by statute to obtain labour

insurance and social insurance for their employees.

There is no statutory insurance specifically required for contractors to carry out construction work, or design and supervisory services.

Contractors usually purchase and maintain fire insurance or contractors' all risk insurance for the executed portion of the construction work, materials and/or building equipment delivered to the construction site. Considering that, recently, construction works have become larger and more complicated, under the Seven Associations GCCC, contractors are required to purchase fire insurance, contractors' all risk insurance or other agreed insurance.

Also, contractors purchase guarantee insurance for liability for non-conformity and non-performance of obligations when they construct new residences, to address the requirement under the Act on the Assurance of Performance of Specified Housing Defect Warranty.

Regarding design and supervisory services contracts, if the designers and supervisors are from an architectural firm, the founders of the architectural firm have a duty to make efforts to purchase and maintain business insurance that covers losses in connection with their design and supervisory services.

7.4 Insolvency Contractual Provisions

There are a few provisions related to insolvency under the Seven Associations GCCC and the Four Associations GCDS. However, parties can separately agree to include insolvency-related provisions and limited recourse clauses, including prohibiting contractors from filing for bankruptcy for a certain period.

Statutory Rules

The Civil Code contains a special rule when the employer is insolvent. During the insolvency procedure, the employer's bankruptcy trustee (or, in the case of civil rehabilitation, the employer with the court's permission) and the contractor may terminate the construction contract, if the work is not completed.

On the other hand, the Bankruptcy Act or the Civil Rehabilitation Act applies when the contractor is insolvent and the work can be completed by another contractor. During the contractor's insolvency procedure, the contractor's bankruptcy trustee (in the case of civil rehabilitation, the contractor with the court's permission) has an option to terminate the construction contract or request the employer to perform its obligation including payment of construction fee.

In both cases, contractors are entitled to receive construction fees in proportion to the progress of the work. However, in the case of employers' bankruptcy, such remuneration will be paid in the insolvency procedure to the extent that there are enough funds to distribute.

7.5 Risk Sharing

In general, risk allocation is an issue to be agreed between the parties.

In the context of typical construction contracts, (i) before the delivery of the completed facility, the contractor bears all risks other than loss or damage incurred that are attributable to the employer, and (ii) upon delivery, such risks transfer to the employer. Having said that, in case of force majeure, some contractors' obligations before the delivery can be deferred or released. Please see 5.5 Force Majeure.

8. Contract Administration and Claims

8.1 Personnel

Under the Construction Business Act, contractors are obliged to engage a chief engineer, and, in certain cases, a managing engineer, an assistant managing engineer, and/or a specialised engineer. They must satisfy the requirements stipulated in the act, mainly to have certain licences and experience. Also, contractors may engage an on-site agent.

Reflecting these statutory requirements and provisions, the Seven Associations GCCC includes a provision requiring the contractor to engage the necessary personnel and notify the employer of the names of such personnel.

Under the Seven Associations GCCC, one person may be a chief engineer, managing engineer or assistant managing engineer, specialised engineer and on-site agent at the same construction site concurrently.

8.2 Subcontracting

In principle, subcontracting all of the construction work is prohibited under the Construction Business Act. However, for constructions of any type other than new apartment buildings, the Construction Business Act allows subcontracting all of the construction work with the prior written consent from the employer. Also, there is no statutory limitation on subcontracting part of the construction work.

These are also reflected in construction contracts, including the Seven Associations GCCC, that is, the contracts prohibit subcontracting all of the construction work without obtaining the prior written consent of the employer for constructing facilities other than a new apartment

building, in which case subcontracting all of the construction work is prohibited in any case.

8.3 Intellectual Property

The Seven Associations GCCC provides that the contractor shall be solely responsible for using any materials, building equipment, or construction methods which contain any protected third party intellectual property (IP), except if all of the following requirements are met: (i) the employer designated the materials, building equipment or construction method, (ii) the design documents do not clearly state that they contain third party IP, and (iii) the contractor is not aware of such third party IPs.

In the Four Associations GCDS, the general rule for intellectual property is that any IPs attached to the completed building based on the design prepared by the designer belong to such a designer, and the employer may use such IPs.

9. Remedies and Damages

9.1 Remedies

Employer

In case of any breach, including non-conformity, under construction contracts or design contracts, the employer is typically entitled to require the contractor or designer to:

- repair the defect or deliver a substitute;
- reduce the payment amount;
- compensate for loss or damages; or
- terminate the contract.

These remedies are not mutually exclusive and employers may choose any option to recover the loss or damage incurred.

Contractor and Designer

The most important claim for contractors and designers is remuneration for construction or design and supervisory work. If the employer fails to pay, the contractor or designer is entitled to claim default charges, in addition to the remuneration itself.

In addition, under the Seven Associations GCCC, a contractor may stop the construction work or terminate the construction contract if the employer fails to ensure and provide the necessary construction site, or pay the milestone payments.

As for designers, the Four Associations GCDS provides that a designer may stop the work or terminate the design contract if the employer fails to pay the design fees, or the work is delayed due to a reason attributable to the employer.

9.2 Restricting Remedies

In Japan, it is not common practice to contractually limit the remedies available to employers and contractors. Conversely, the Seven Associations GCCC clarifies that all remedies available to employers in case of non-conformity by the contractors under the Civil Code are also available to the extent employers follow the procedural requirements. Please see **3.11 Defects and Defects Liability Period** for such procedural requirements.

Having said that, employers and contractors may agree to limit the available remedies to the extent that such limitations do not violate public order or (in case the employer is a consumer) the Consumer Contract Act. Please see **6.1 Exclusion of Liability**.

As for the design contracts, compared with construction contracts, limitations on the com-

pensation amount are more acceptable in the Japanese market.

9.3 Sole Remedy Clauses

In Japan, contractual sole remedy clauses are not used in most construction contracts. Hence, generally speaking, in addition to remedies stipulated in construction contracts, employers and contractors may make a claim under applicable laws such as tort law.

9.4 Excluded Damages

In the Japanese market, contractors are generally liable for all forms of damage unless it is attributable to or directed by the employer. The basic idea is that contractors bear every risk for completing the construction work until the delivery, which is one of the contract types stipulated in the Civil Code.

9.5 Retention and Suspension Rights

Retention Right

In Japan, the payment of the remuneration for construction is often divided into several portions, such as the payment at commencement, single or multiple middle milestones and the completion of the work. Middle milestones include the completion of the framework of the buildings, and the last payment is paid only after passing the agreed tests and statutory inspections. Typically, although it depends on the agreement between the parties, the last payment is the biggest amount.

After the last payment has been made at the same time as the delivery, it is generally not acceptable for an employer to retain any fees. Thus, if any defects are found after the delivery, the employers need to claim compensation without any retention.

Hence, employers are substantially able to retain part of the payment only before the completion of work and delivery.

As for the designers, practically, all designing fees are paid after the completion of work. As such, similar to the contractors, the employers are able to retain the payment only before the completion of work and delivery.

Suspension Right

Contractors' and designers' suspension rights are incorporated in construction contracts and design contracts, including the Seven Associations GCCC and the Four Associations GCDS.

Typical grounds for suspending construction works are:

- delay of the employer in making advances or partial payments;
- not possible to proceed with the construction work because the employer failed to make the construction site available for the use of the contractor;
- significant delay in the construction work due to any ground attributable to the employer; and
- not possible to proceed with the construction work because of Force Majeure.

In addition, the common grounds for suspending design works are:

- delay in making any payments due to a reason attributable to employer; and
- delay in the work due to a reason attributable to the employer.

9.6 Termination

Termination Event

The termination events are agreed upon by parties and provided in construction contracts. The termination events in the Seven Associations GCCC include the following:

- Termination by the employer of the construction contract:
 - (a) before the work is completed: when necessary, by compensating the contractor for the loss and damage incurred;
 - (b) after the completion and delivery: if the defects of the facility are so material that there is no option but reconstruction;
 - (c) contractor loses its any necessary permit to continue the construction work;
 - (d) not possible to complete the construction work; and
 - (e) contractor is found to have any relationship with antisocial forces.
- Termination by the contractor of the construction contracts:
 - (a) employer's breach (excluding minor breaches) of the construction contract;
 - (b) construction work has ceased for more than two months or one-fourth of the scheduled construction timeline;
 - (c) construction fees are reduced for more than two-thirds of the original amount due to a variation request from the employer;
 - (d) employers have stopped paying their debt and lack the ability to pay the construction fees;
 - (e) not possible to complete the construction work; and
 - (f) employer is found to have any relationship with antisocial forces.

As for the design contracts, both the employers and the designers may terminate the contracts at any time without any reason.

Contractual Consequences of Termination

Regardless of the ground for termination of the construction or design contract, the work completed as of the time of termination will be transferred to the employer for consideration: the employer is required to pay part of the remuneration of the contractor in proportion to the progress of the work.

Parties are also entitled to compensation for loss or damage incurred due to the termination of the contract.

10. Dispute Resolution

10.1 Regular Dispute Resolution

In Japan, parties may agree to the exclusive jurisdiction of a competent district court in construction or design contracts. Typically, a court with sufficient ability and personnel, such as the Tokyo District Court, is chosen as an agreed competent court. As construction disputes tend to have complicated and technical issues, special procedures to obtain support from experts are stipulated in the Japanese code of civil procedure.

Some large-scale courts including the Tokyo District Court, have set up judicial units handling construction disputes intensively, and such units are able to manage such cases smoothly. Though parties are not allowed to choose a judicial unit to deal with the case, complicated construction disputes are likely to be assigned to such intensive units, if they exist. This is a good reason to choose a large-scale court as an agreed competent court in construction and design contracts.

10.2 Alternative Dispute Resolution

Two ADR institutions are typically chosen for construction dispute resolution: (i) the Committee for Adjustment of Construction Work Disputes (CACWD) established at MLIT and each prefecture by the Construction Business Act, and (ii) the Designated Housing Dispute Resolution Body (DHDRB) set up at each bar association by the Housing Quality Assurance Act, which is designated by MLIT. CACWDs are public institutions handling construction contract disputes, and DHDRBs are private institutions dealing with construction contract disputes and the sale of residences covered by a performance evaluation report issued in accordance with the Housing Quality Assurance Act. Both CACWD and DHDRB are expected to resolve construction-related disputes in an effective, simple and prompt manner, with the support of experts in construction.

There are three types of procedure in CACWD: (i) mediation, (ii) conciliation and (iii) arbitration. Resolution by mediation and conciliation can be achieved only through the agreement on the result among the parties. Hence, they are not always effective. On the other hand, an arbitration award from CACWD can be granted without any agreement on the result between the parties, provided however, that the consent of the parties to commence an arbitration is required.

Due to such nature of CACWD, the Seven Associations GCCC designates CACWD as the recommended body for dispute resolution in addition to a court judgment and has prepared the format of the advance agreement on commencing arbitration in CACWD which excludes going to courts. But it is not always selected as the first option for the dispute resolution, and contractors tend to choose resolution in courts (or they select to avoid disputes in the first place by repairing the defects to protect their reputation). One reason may be the provision under the Arbitration Act, which allows consumers to terminate such agreement on commencing arbitration, for the purpose of protecting individuals.

KUWAIT

Law and Practice

Contributed by:

Alex Saleh, Mohammad Nader Al Awadhi, Rana Moustafa and Lujain Burhamah
GLA & Company



Contents

1. General p.360

- 1.1 Governing Law p.360
- 1.2 Standard Contracts p.360

2. Parties p.360

- 2.1 The Employer p.360
- 2.2 The Contractor p.361
- 2.3 The Subcontractors p.362
- 2.4 The Financiers p.363
- 2.5 The Designer p.363

3. Works p.364

- 3.1 Scope p.364
- 3.2 Variations p.364
- 3.3 Design p.364
- 3.4 Construction p.364
- 3.5 Site p.364
- 3.6 Permits p.365
- 3.7 Maintenance p.365
- 3.8 Other Functions p.365
- 3.9 Tests p.365
- 3.10 Completion, Takeover and Delivery p.365
- 3.11 Defects and Defects Liability Period p.365

4. Price p.366

- 4.1 Contract Price p.366
- 4.2 Indexation p.366
- 4.3 Payment p.367
- 4.4 Invoicing p.367

5. Time p.368

- 5.1 Planning and Programme p.368
- 5.2 Delays p.368
- 5.3 Remedies in the Event of Delays p.368
- 5.4 Extension of Time p.369
- 5.5 Force Majeure p.369
- 5.6 Unforeseen Circumstances p.369
- 5.7 Disruption p.370

6. Liability p.371

- 6.1 Exclusion of Liability p.371
- 6.2 Wilful Misconduct and Gross Negligence p.371
- 6.3 Limitation of Liability p.371

7. Risk, Insurance and Securities p.372

- 7.1 Indemnities p.372
- 7.2 Guarantees p.372
- 7.3 Insurance p.373
- 7.4 Insolvency p.374
- 7.5 Risk Sharing p.374

8. Contract Administration and Claims p.375

- 8.1 Personnel p.375
- 8.2 Subcontracting p.375
- 8.3 Intellectual Property p.376

9. Remedies and Damages p.376

- 9.1 Remedies p.376
- 9.2 Restricting Remedies p.376
- 9.3 Sole Remedy Clauses p.377
- 9.4 Excluded Damages p.377
- 9.5 Retention and Suspension Rights p.377
- 9.6 Termination p.377

10. Dispute Resolution p.378

- 10.1 Regular Dispute Resolution p.378
- 10.2 Alternative Dispute Resolution p.378

GLA & Company is a regional law firm based in the United Arab Emirates (UAE), providing strategic, cost-effective and forward-thinking legal representation for companies seeking to do business in the Middle East. The firm is proud to hold a diverse portfolio of clients, from start-ups to global enterprises. GLA's practice consists of a full-service law firm, from simple advisory work to complex contentious and non-contentious matters.

With extensive experience in advising clients in the key Gulf Cooperation Council (GCC) states of Kuwait, Saudi Arabia, Qatar, the UAE, Egypt and Lebanon, the firm offers unique insights for companies seeking quality legal services. Data protection and privacy is an area of special attention for the firm, considering the expansion and revamping of applicable laws and regulations across the GCC.

Authors



Alex Saleh is a founder and managing partner of GLA & Company, and takes a leading regional role in the firm concerning its M&A and private equity practice. With over 25

years of experience both in the Gulf Cooperation Council and in the USA, he has accumulated considerable expertise in the areas of banking and finance, M&A, capital market deals and infrastructure projects. His experience garners praise from leading legal directories, and his transactions regularly win Deals of the Year from such institutions and organisations.



Mohammad Nader Al Awadhi is a corporate and commercial lawyer, as well as a commercial and civil litigator, representing multinational companies and joint ventures in connection with

litigation and possible litigation strategies. He also regularly leads and assists GLA & Company's corporate team in the Kuwait office with their day-to-day matters, with a primary focus on legal issues arising from corporate affairs in Kuwait. Mohammed prides himself in leading the firm on acquisitions in all sectors of the Kuwait and regional market.



Rana Moustafa is an associate at GLA & Company with extensive experience in international and domestic commercial disputes, spanning the Gulf Cooperation Council

and Europe. She has represented clients in Kuwait, Lebanon, Qatar, the UAE, Saudi Arabia, Egypt and France. She has experience in international and domestic arbitration, working on matters held under the auspices of the ICC, DIFC-LCIA, CRCICA, DIAC, ICSID and CAS. Rana increased her experience in data protection while working on matters related to data protection disputes, data protection frameworks at the workplace and data protection policies for clients. She is a member of the Egypt Bar Association and is currently studying for the French Barreaux.



Lujain Burhamah is an associate at GLA & Company.

She has a background in international commercial arbitration, international investment arbitration and energy, as well as international commercial law. Lujain's practice focuses on complex construction disputes. Lujain is also heavily involved in corporate and commercial advisory.

GLA & Company

Alex Saleh
Managing Partner

Tel: Kuwait +965 669 55516
UAE +971 54 997 4040
Email: alex.saleh@glaco.com
Web: www.glaco.com/attorneys/alex-saleh



1. General

1.1 Governing Law

The principal laws governing the construction market in the State of Kuwait are:

- the Kuwait Civil Code, Law No 67 of 1980 (the “Kuwait Civil Code”);
- the Kuwait Commercial Code, Law No 68 of 1980 (the “Kuwait Commercial Code”);
- the Kuwait Public Tenders Law, Law No 49 of 2016, as amended by Law No 74 of 2019, and its executive regulations (the “Public Tenders Law”); and
- the Kuwait Public Private Partnerships Law, Law No 116 of 2014 (the “PPP Law”).

1.2 Standard Contracts

In Kuwait, standard contracts are commonly used (eg, FIDIC, NEC3) among contractors and employers to facilitate the drafting phase, and to ensure that all parties are following the standard practice for the region as well as globally, with the understanding that one of the parties is usually a foreign entity.

In the authors’ experience, contracts often originate from or are inspired by International Federation of Consulting Engineers (FIDIC) forms, and it is common practice for parties to adopt these forms of contract. Publicly known forms that are often used include the following:

- the Conditions of Contract for Construction (Red Book);
- the Conditions of Contract for Plant and Design-Build (Yellow Book); and
- the Conditions of Contract for EPC/Turnkey Projects (Silver Book).

As for other mega-projects and PPP works, a list of standard contract conditions is published

on the Central Agency for Public Tenders (CAPT) website, showing conditions that must be included in build-and-operate contracts, consultancy agreements, bids and tenders, subcontractors’ agreements and design contracts.

It is critical to note that, while standard contracts are commonly used, Kuwaiti law may differ in the interpretation and enforcement of standard contractual provisions.

2. Parties

2.1 The Employer

The companies and institutions typically involved as employers in construction projects are either wholly or partly state-owned entities or private entities such as commercial and leisure real estate developers, and project companies that are set up for a specific mega-project collaborating with the government (that holds a minority share in the project company).

Employers for construction projects in Kuwait typically include oil and gas, power and water companies.

An employer’s primary rights are:

- to receive the work from the contractor in accordance with the contract;
- to terminate the contract; and
- to recover damages suffered for delay in completion of the works.

Employers often have a right to select the contractor and/or subcontractors; however, most major projects require a fair and non-discriminatory bidding process to ensure equal opportunity, and thus the employers are required to select a bidder based on certain criteria.

Often, employers have a right to issue changes to the works, and contractors often become contractually obligated to proceed with such changes. In such cases, of course, contractors are entitled to a variation in their compensation and schedule to account for the changes made by the employer.

An employer's primary obligations are:

- to issue timely payment for works completed in accordance with the terms of the contract;
- to facilitate access to the site (including obtaining permits, clearances, gate passes, etc); and
- to perform the contract according to its terms, prevailing custom, principles of equity and Kuwaiti legal principles of good faith and honourable dealing.

2.2 The Contractor

The main contractors in Kuwait usually include a mix of local and foreign construction companies. Mega-projects, such as the Al Zor Refinery Project, the Umm Al Hayman Wastewater Project and the Clean Fuels Project, often include foreign partnerships, joint ventures and foreign consortiums.

However, foreign construction companies are expected to play a greater or more direct role within construction projects in Kuwait. This expectation follows recent amendments to Article 24 of the Kuwait Commercial Code and Article 31 of the Public Tenders Law. Under the previous legislation, foreign companies were not able to establish a branch in Kuwait or engage in business activities in Kuwait unless this was through a Kuwaiti agent. Also, in the absence of an exemption from the relevant authority, generally only Kuwaiti individuals or companies were able to submit bids for tenders or contracting.

Under the amended legislation, foreign companies may establish a branch in Kuwait and, through the same entity, engage in business activities in Kuwait without the prerequisite need for a local agent. Additionally, the amended legislation does not limit the submitting of bids for tenders or contracting to Kuwaiti individuals or companies. As a result, foreign entities may submit bids for tenders or contracting.

The effect of these amendments is that foreign construction companies do not need an exemption from the relevant authority to submit bids for tenders or contracting in respect of construction projects, nor do they need, as a precondition, a Kuwaiti partner or agent to submit a bid. With the unrestricted opportunity to bid for tenders or contracting against local entities, it is likely that foreign entities will participate in a greater selection of construction projects in Kuwait. This is in line with the objectives of the amendments, set out in Explanatory Memorandum for Law No 1 of 2024 Regarding Amending Article 24 of the Kuwait Commercial Code and Article 31 of the Public Tenders Law, which provide that authorities are no longer permitted to limit any offering to national or foreign companies. The intended effect is to open the market further by allowing greater and wider participation of foreign investment, which, in theory, should lead to better competition and choices within the market.

While the previous legislation, in like manner to the amended legislation, allowed foreign entities who submit bids for tenders or contracting to be exempt from complying with certain local partnership requirements, the effect of the amended legislation is that foreign entities do not need to submit bids for tenders or contracting in order to establish a branch in Kuwait wherein they can carry out their business activities. This allows foreign construction companies

to facilitate their construction-related business operations in a direct manner, whether in respect of activities under bids for tenders or contracting, or of other activities. Significantly, foreign construction companies may execute, or support their operations for, a contract through their own branch in Kuwait and without local partners such as agents. In relation to the application of the amendments, regulations to come may provide clarification in this respect and in respect of related considerations such as employee sponsorship.

It is common for special purpose vehicles (SPVs) to be set up for large-scale projects to ensure effective risk management; however, the main contractors with the employer will often remain the parent entities. SPVs generally take the form of limited liability companies, but may also take the form of closed or public shareholding companies. SPVs in the construction industry are often created between a local contractor, an international contractor and (for example) a facilities management contractor. It is also common, especially with PPP projects, for employers to partake in the ownership of these SPVs.

For smaller projects, local companies are often assigned the contract.

A contractor's main rights are:

- to receive timely payment for works agreed and additional works approved by the employer, in some cases and as required under the circumstances; and
- to receive extensions of time in the event work is delayed due to a circumstance outside the control of the contractor (eg, force majeure, changes caused or requested by the employer).

A contractor's main obligation is to execute the work in accordance with the contract's requirements and specifications as required by applicable regulations, and to pay its subcontractors for their completed work in a timely manner.

The Kuwait Civil Code also sets obligations on the contractor, such as to remedy defects and to perform the work in accordance with the current usage and within a reasonable time limit as required by the nature of the work, with due consideration of usage in the trade.

The contractor is also obligated to inform its employer immediately about any defects caused or revealed in the course of the work in the materials provided by the employer, or where other elements have arisen which tend to impede performance of the work in appropriate conditions. If the employer provides the contractor with materials, the contractor becomes obligated to act as the safekeeper of those materials, including being obligated to:

- observe technical skills in using such materials;
- be able to account for them; and
- return any surplus material to the employer.

2.3 The Subcontractors

The main contractor will often subcontract parts of the work to specialist subcontractors and, in many cases, will be required to accept subcontractors that have been nominated by the employer. Subcontracting is permitted, provided it is allowed for in the main contract. Given the scale of the projects and the specialist works required, subcontracting is very common, particularly in relation to specialist fields such as:

- design/engineering, enabling and foundation works;

- mechanical, electrical and plumbing works;
- facade works; and
- any specialist systems required for the project.

Subcontractors have the same rights and obligations towards the contractor that the contractor has towards the employer. One key right afforded to subcontractors in Kuwait, in addition to those the contractor has in relation to the employer, is expressly provided for in the Civil Law: the right to obtain payment directly from the employer (from monies owed or due to be owed by the employer to the main contractor). In such cases, where the subcontractor is entitled to monies from the contractor, and the contractor has failed to make payment to the subcontractor, the subcontractor may claim such amounts directly from the employer.

2.4 The Financiers

Relevant institutions that typically act as financiers in a construction project include banks and financing institutions that are well known in Kuwait.

Public bodies are another structure that may be responsible for financing construction projects in Kuwait.

In 2014, the Kuwait Authority for Partnership Projects (KAPP) was established to oversee all PPP projects and to promote private sector participation in infrastructure development. The main aim of the KAPP was to establish a long-term development plan for the country and to attract private sector investors in key strategic industries such as energy, water, transportation and healthcare. In some cases, a governmental entity may take part in financing a construction project.

2.5 The Designer

In Kuwait, various types of companies and institutions may act as designers in a construction project, including architectural firms, engineering firms, design consultancies and (sometimes) specialised design divisions within construction companies.

In general, the rights and obligations of the designer under a construction contract in Kuwait include the following.

- Rights:
 - (a) the right to be paid for their services;
 - (b) the right to have their designs implemented faithfully;
 - (c) the right to intellectual property associated with their designs; and
 - (d) the right to professional indemnity insurance coverage.
- Obligations:
 - (a) the obligation to produce designs that meet the employer's requirements and standards;
 - (b) the obligation to adhere to regulatory requirements and building codes;
 - (c) the obligation to co-ordinate with other project stakeholders; and
 - (d) the obligation to provide accurate and timely design documentation.

In Kuwait, the relationship between the designer, the employer and the contractor involves close collaboration throughout the project's life cycle. The designer works closely with the employer to understand project requirements and objectives, translating them into design concepts and specifications. The contractor relies on the designer's plans and specifications to carry out the construction work accurately. Effective communication and co-ordination between all par-

ties is essential to ensure the successful delivery of the project.

3. Works

3.1 Scope

The scope of work in a construction contract is usually predetermined and agreed upon between the parties in the contract itself, or during the life of the project through additional addendums to the initial scope of work or through change orders.

The programme of requirements and specifications is often built up and assembled by the employer or the consultant in charge, before the project commences. The value-engineering options and specifications are also determined and fixed by the employer, agreed upon and presented to the contractor who will execute and perform them.

3.2 Variations

Procedures for variation orders and changes are usually determined in the contract, in order to allow the parties to the agreement – specifically the contractor – to apply for a change proposal and for the employer to be able to respond by either rejecting or approving this.

In the authors' experience, changes and variations issued by the employer, either by its own demand or by request of the contractor, typically fall within the contractual provision stating and allowing for this. Changes are usually gateways for entitlements to financial adjustments and time extensions. The authors have encountered cases involving claims for prolongation or time extension due to changes or variations that occurred to the provisional turnover schedule stipulated in the contract. In such circum-

stances, time extensions for the completion of the works would be implemented and claims for prolongation costs would take place.

3.3 Design

In colossal construction projects, the design responsibilities are often handled by a design consultant that is engaged by the employer.

3.4 Construction

The divisions of work would be mostly undertaken by two key players: the contractor/sub-contractor and the employer. The responsibility of the employer would typically include payment and financial obligations. The engineer or consultant would mainly be responsible for supervising the execution and performance works. Lastly, the contractor would be mostly or entirely responsible for the execution of the works.

3.5 Site

The accessibility of the site is usually the responsibility of the employer, who is responsible for granting the contractor access to the site within the time required by the programme of the works. The employer is also responsible for informing the contractor of the status of the site, including existing pollution and ground conditions.

Once the site is under the custody of the contractor, the contractor is responsible for the site. When in possession of the site, the contractor is normally responsible for the maintenance of the site, health and safety measures, and the levels of on-site noise and pollution.

With respect to archaeological finds, the party (whether the contractor/subcontractor or the employer) who makes the discovery is responsible for reporting it to the authorities and for informing the contractual parties to ensure that

all works are halted until an investigation has taken place.

3.6 Permits

In general, construction permits are acquired from the Kuwait Municipality, and this acquisition would mainly be the responsibility of the employer.

Further, once the permits have been obtained for the design of the works, the contractor is responsible for obtaining permits for the execution of the works.

3.7 Maintenance

According to the Kuwait Civil Code, amounts due to contractors and engineers who have been entrusted with the erection, reconstruction, repair or maintenance of buildings or other works have a privilege over such works to the extent of the increase resulting from such works and of the value of the immovables at the time of sale (Article 1081 of the Kuwait Civil Code).

The contractor is usually the party responsible for the maintenance of the works. Corrective works during the defect liability period are undertaken as per the division of works in the contract.

3.8 Other Functions

The employer is usually responsible for operation, finance and transfer functions. In certain cases, there may be exceptions for PPP projects or for build, own, operate or transfer contracts.

3.9 Tests

Typically, the process universally used for construction projects when implementing a test for completion of the works is enshrined in the contract, and is agreed upon between the parties prior to starting the works. However, it is

worth noting that many standard construction contracts are inspired from a FIDIC form, which, in the Red Book, provides that tests for completion be undertaken by the engineer in charge, the design consultant or the principal within 14 days from the date following notification.

3.10 Completion, Takeover and Delivery

Once the completion certificate is issued and the completion date arrives, the employer would be invited to take over the works from the contractor. The delivery date is considered as the date on which the takeover occurs, either implicitly or explicitly.

3.11 Defects and Defects Liability Period

There is a decennial liability provision under Articles 692 to 697 of the Kuwait Civil Code, placing joint liability on the contractor and the designer in charge if the subject of the construction project is deteriorated. Specifically, the architect/engineer and contractor are jointly liable for total or partial destruction or damage, and for any defect that threatens the strength and safety of a building or a fixed construction, for ten years from collapse or three years from discovery of defect.

Furthermore, the contract would often include a provision referring to the contractor's obligation to remedy the defects or to complete any remaining works within the scope of works stipulated in the contract.

Also relevant is the concept of *responsabilité décennale*, which originated in the French Civil Code (Article 1792-1) and evolved from a desire to protect building owners who could not ordinarily be expected to possess the technical expertise required to identify defects in design or construction at the point of delivery of a project, particularly where such defects were latent.

4. Price

4.1 Contract Price

Contract payments can generally be categorised into two types: fixed lump sum or remeasurement contracts.

In fixed lump sum contracts, and in accordance with Article 690 of the Kuwait Civil Code, the contractor does not have the right to demand a price increase. This remains the case even if modifications or additions are made to the construction plan, unless such changes are a result of the employer's fault or have been expressly authorised by the employer.

In a remeasurement contract, the value of the work is calculated based on an estimated pre-determined price schedule or Bill of Quantities (BOQ). The BOQ would usually include an extensive inventory outlining the materials, components and labour necessary for the successful execution of the construction project. In that regard, Article 689 of the Kuwait Civil Code stipulates that, if it becomes evident during the execution that it will be necessary to significantly exceed this estimate, the contractor is obliged to promptly inform the employer – and failure to promptly notify the employer would result in the contractor forfeiting the right to claim this increase.

The most frequently used approach for payment is usually tied to the certification of completed work by the contract administrator/project manager/PMC, which would be in accordance with applicable Kuwaiti law (specifically Article 677 of the Kuwait Civil Code). This certification, which is usually followed by an inspection of the finished work, occurs either periodically or at pre-determined milestones or stages as agreed upon beforehand. The value or percentage of the over-

all contract price is usually tied to the completion of the milestone(s) as pre-established within the agreement, and once such milestone(s) and subsequent inspection are completed, a contractor is expected to be paid in accordance with that determined percentage.

4.2 Indexation

In Kuwait, indexation of prices is commonly used in construction contracts to manage the risk of large price fluctuations, especially considering the potential impact of volatile market conditions and inflation.

The risk of large price fluctuations is typically divided between parties through contractual arrangements and mechanisms, such as the following.

Indexation Clauses

Contracts may include clauses that tie the contract price to a specified index, such as a consumer price index (CPI) or a construction cost index. This allows for automatic adjustments to the contract price based on changes in the selected index, thereby mitigating the risk of price fluctuations.

Price Escalation Provisions

Contracts may include provisions that outline how price escalation or adjustments will be calculated and applied in the event of significant changes in market conditions, such as fluctuations in material costs or currency exchange rates.

Risk-Sharing Agreements

Parties may negotiate risk-sharing agreements where both parties agree to share the impact of price fluctuations up to a certain threshold, beyond which one party may bear a larger portion of the risk.

Fixed-Price Contracts Versus Cost-Reimbursement Contracts

The choice between fixed-price contracts and cost-reimbursement contracts can also influence how the risk of price fluctuations is allocated. Fixed-price contracts shift more risk to the contractor; while cost-reimbursement contracts may provide greater flexibility but can expose the employer to more risk.

Overall, the specific allocation of risk for price fluctuations in construction contracts in Kuwait depends on the negotiation and agreement between the parties, with indexation of prices being a common strategy for managing this risk.

4.3 Payment

It is important to note that, in the absence of applicable legal provisions governing due dates of payments, the specific measures and provisions regarding late or non-payment can vary depending on the terms and conditions of the individual construction contract. Parties may negotiate and customise these provisions to suit their particular project requirements.

In government contracts involving large and complex projects, advance payments to the contractor are usually utilised. These payments provide financial support to the contractor to cover initial project costs such as mobilisation, procurement of materials and hiring of labour. Advance payments serve as a form of assurance to the contractor that funds are available to start the project – this is especially the case for foreign contractors.

Throughout completion of the project, the contractor is usually paid through interim payments, as the contract usually defines the percentage of work completion required to trigger an interim payment. These payments allow the contractor

to cover ongoing expenses and ensure a steady cash flow throughout the project.

Delayed payments may occur due to various reasons, such as administrative delays, financial constraints or disputes between parties. In such cases, contractual provisions may specify a grace period or a timeframe within which payments should be made. If payment is not made within the specified timeframe, this may trigger consequences such as interest accrual or the right to suspend work.

That said, Article 110 of the Kuwait Commercial Code stipulates that, if an employer is obligated within a contract to provide payment within an agreed timeframe, they are obligated to provide the contractor with compensation for delay in payment. This compensation takes the form of legal interest, which is fixed at an annual rate of 7% from the due date of the payment. Late payments may also be dealt with by providing the employer with legal notices compelling payment within a specified date, and these may be issued by the contractor or by the competent local courts.

4.4 Invoicing

The specific invoicing method used may vary depending on the terms and conditions of the construction contract. The chosen method should be clearly defined in the contract to ensure transparency and to facilitate smooth payment processes.

Invoicing methods (agreed upon between the parties) may include a delivery of invoices in physical form, usually as hard copies. However, certain contracts may utilise electronic systems, such as ACONEX or Focus, to simplify the document-exchange process, including for the submission of invoices.

5. Time

5.1 Planning and Programme

Planning in construction-related activities and projects would likely involve the planning of the validity of the permits, the accessibility of the site, etc. Categories of permitted construction-related activities and their corresponding licensing requirements depend on the type of project, the height of the building and any internal directives that may be applied by the ministry in charge.

Furthermore, planning would occur in the period before commencing work. Foreign entities seeking to work on construction projects in Kuwait must have a foreign investment licence from the Ministry of Commerce and Industry and a commercial presence in Kuwait. All consultants and contractors must also obtain a classification/licence from the Ministry to carry out the works in Kuwait.

The planning process before or during the construction works also involves various permits, including:

- permits for civil works;
- environmental permits;
- permits related to the roads or key transport routes that will be used by the contractor or subcontractors throughout the project; and
- all other relevant governmental permits.

Upon completion of the works, the contractor would need to request a completion certificate from the employer.

5.2 Delays

In the event of a delay, the obligations of the parties are usually enshrined in the provisions of the contract, stipulating the procedure that

should be followed internally between the contractor and the employer to reach a settlement or to resolve the delay issue.

Further, the contract usually provides that the contractor should notify the employer upon the occurrence or the prediction of a potential delay. The notice should include the amounts that were incurred and the expected costs and time.

Under the Kuwait Civil Code, the primary circumstances where delays are excusable are:

- where the counterparty fails to perform its obligations;
- where the delay is caused by a third party outside the control of the responsible contracting party;
- where an unforeseeable extraordinary circumstance renders the performance of the obligation oppressive, if not impossible; and
- where the delay is caused by a force majeure event.

In Kuwaiti construction practice, there may be excusable and non-excusable delays. When concurrent delays occur, the contractual stipulation would most probably govern the situation.

5.3 Remedies in the Event of Delays

Generally, in Kuwait, the employer would be entitled to remedies in the event of delays if the delays are due to a cause immediately related to a breach by the contractor. The Kuwait Civil Code Article 293 provides that “in the case of impossibility or delay of performance in rem of an obligation, the debtor must compensate the damage resulting therefrom to the creditor, save where the debtor establishes that non-performance or delay of performance was due to a cause beyond his control”.

5.4 Extension of Time

The extension of time would be awarded based on the procedure provided in the contract. In the authors' experience, the extension-of-time request would be submitted by the contractor to the employer, and the employer would need to answer and respond to such notice within a certain period, usually 30 days or 45 days.

The extension-of-time root cause could be changed by law, change orders or variations in general that would considerably affect the provisional turnover dates, the force majeure event or an event that severely impacted the timeline of the project.

Kuwaiti courts would likely dismiss claims that the extension-of-time claim should be raised in a certain period. Even when time limits stipulated in the contract are not respected, the courts have requested common reasons for an extension of time, including:

- adverse weather;
- variations to the works by the employer; or
- difficulties encountered on-site.

5.5 Force Majeure

In some contracts, such as FIDIC standard form contracts, there is an option that allows claiming for a circumstance considered as force majeure. The Kuwaiti legislators have described force majeure and emergency situations as a cause external to the contract. In particular, Articles 214 and 215 of the Kuwait Civil Code provide that a force majeure circumstance is a context where the performance of the contractual obligation is impossible due to an external reason beyond the control of the performing party, and there the contract shall be automatically revoked.

Furthermore, Article 437 of the Kuwait Civil Code specifies that the force majeure event should not be predictable.

As inspired by the French Civil Code, the Kuwaiti legislature establishes that the force majeure circumstance could be traced using a series of criteria or a series of elements, including the following:

- unforeseeability – the event must not have been within the limits of the foreseeability or predictability of a person or of a reasonably diligent individual *ab initio*;
- unavoidable – the circumstance should not have been avoidable or capable of being prevented with duty of care or mitigation;
- impossibility – meaning, in the same vein as the above two factors, that the circumstance giving rise to the force majeure renders the contractual obligations “impossible” to accomplish or execute; and
- the force majeure circumstance is external, meaning that it is out of the hands of either party to the contract.

According to Article 295 of the Kuwait Civil Code, “it is permissible to agree that the obligor will bear liability for *cas fortuit* and force majeure”.

5.6 Unforeseen Circumstances

Issues regarding unforeseen circumstances are governed by the terms of the construction contract and the Kuwait Civil Code. So long as the contractual provisions do not contravene express provisions in the law, they will be upheld.

Various provisions of the Kuwait Civil Code apply to unforeseen circumstances. For example, if, prior to delivery or takeover, the work has perished or sustained damage due to a force majeure event, the contractor may not claim

the agreed consideration or reimbursement of their expenses, unless the employer had at the time of the perishing or damage breached its obligation of taking over the work. Likewise, in such case the employer will not be able to claim the value of the materials provided, unless the contractor was, at the time of the perishing or damage, in default of their obligation to deliver the work and has not established that the thing would have sustained damage had they made timely delivery.

While the Kuwait Civil Code generally prohibits the costs (of the contractor) for completing works from affecting the extent of the contractor's obligations, in the event of an unforeseen extraordinary circumstance which renders the performance of the obligation arising therefrom oppressive (if not impossible) and which would result in a heavy loss to the contractor, a tribunal may reduce the obligation of the contractor, or increase the price to be paid by the employer for the same obligation. Thus, there are circumstances where the employer may have to pay more for the same amount of work, if an unforeseen extraordinary circumstance occurs – such as new tariffs on raw materials resulting in an extraordinary increase of the cost to the contractor.

For events such as force majeure which may be unforeseen, and barring a provision to contrary, harm resulting therefrom excuses the party who would otherwise be liable for such harm caused. For example, if a war broke out and destroyed the contractor's work in progress, thereby causing the contractor to be delayed and the employer to suffer harm as a result, the contractor would not be liable for the employer's harm because their failure to perform the work was the result of a force majeure event.

Finally, as regards recoverable damages arising from a breach of contract, the Kuwait Civil Code provides that the breaching party is liable only for the harm which normally could have been foreseen at the time of entering into the contract, save where the breaching party committed fraud or gross negligence.

5.7 Disruption

Depending on the cause of the disruption to the works, the contractor may be entitled to an extension of time to perform the obligation, as provided for in the Civil Code. However, contracts usually provide for the circumstances in which a contractor may be entitled to this.

While the concept of disruption is not directly addressed, the Kuwait Civil Code excuses performance of an obligation under the following circumstances:

- unforeseeable extraordinary circumstances;
- events of force majeure; or
- barring a provision to the contrary, when the cause of the delay is due to something beyond the control of the contractor, such as *cas fortuit* or an act by the employer or some other third party (see 5.6 **Unforeseen Circumstances**).

The concept of disruption is not expressly recognised under provisions of the Kuwait Civil Code. Experts broadly acknowledge that construction disruption claims are uncommon in Kuwait. A distinction should be made between the disruption concept and the concept of delays. Here there is little overlap, as in Kuwaiti practice and following Kuwaiti precedents there are not many cases focusing on claims that arise due to lack of productivity or inefficiency in the execution of the project.

In such cases, a basic claim for damages must be established. This means that a breach on the part of the employer should be taken into consideration or proven in some way for the court or the arbitral tribunal to establish the disrupting event that caused the damage affecting the contractor. As is the case in most damages claims, the damage must be established and there must be a link between the cause and the damage.

6. Liability

6.1 Exclusion of Liability

The Kuwait Civil Code lists certain liabilities that are mandatory, such as any liability classified as a crime (eg, fraud) gross negligence or involving death of one of the employees.

In accordance with Article 227 of the Kuwait Civil Code, anyone who has committed a wrongful act that caused harm to others is obliged to compensate them, whether the harm is direct (*mubashir*) or consequential (*mutasabib*), even where the actor is not a discrete person.

6.2 Wilful Misconduct and Gross Negligence

The concepts of gross negligence and wilful misconduct exist under Kuwaiti civil law. The Kuwaiti legislature refers to gross negligence as a breach of the contractual relationship and the duty of care, and to wilful misconduct as a breach of the duty of good faith.

The concepts are covered by the legislation governing contracts, usually the Kuwait Civil Code and Kuwait Commercial Code. One point worth mentioning is that the Kuwaiti legislature does not make a distinction between gross negligence and ordinary negligence – see Salama Ahmad, *Notices in Obligation Theory (First Edi-*

tion, Ain Shams Library), page 266, where the Egypt Supreme Court stated that the doctor was required to exercise prudent care which is consistent with medical principle, and so would be liable for professional negligence and ordinary negligence (Egypt Supreme Court, No 461 of Year 36, 21 December 1971, page 1062).

As such, an important example stated in case precedents is the gross negligence of a doctor. This could be implemented in the case of gross negligence of a contractor or subcontractor in a construction project – ie, when a subcontractor commits an error on the construction site due to its gross negligence or due to not adhering to quantum or scientific calculations, if related to a power plant or a water-waste project.

In one case in the Kuwaiti courts, it was held that the doctor must follow the proper diagnostic procedure and undertake the common medical examination. It was also held that the doctor's fault must be obviously proved, and it must be shown that he performed unprofessionally, whether he was unknowing or negligent, contrary to basic and scientific principles of medical treatment (see Kuwaiti Supreme Court Case No 66, 69/2003 dated 27 October 2003; and Kuwaiti Supreme Court Case No 519/2010 dated 20 April 2011).

For the calculation of damages, the measure of relief may differ where the damage resulted from the breaching party committing fraud or gross negligence (see also **5.6 Unforeseen Circumstances**).

6.3 Limitation of Liability

The Kuwait Civil Code permits parties to predetermine the measure of relief available to them in the event of a breach of contract resulting in damages suffered (see **5.6 Unforeseen Circum-**

stances). However, an agreement will be rendered null if it exonerates a party from liability for an unlawful act *before* the occurrence thereof. In other words, waivers of liability for future acts that contradict express provisions of Kuwaiti law are generally unenforceable.

7. Risk, Insurance and Securities

7.1 Indemnities

In Kuwaiti construction contracts, indemnities are frequently used to manage risk and assign responsibilities among the parties involved. The particular areas for which indemnification may be provided can vary based on the project's nature and the negotiated terms of the contract.

Common subjects for indemnification provisions include the following.

Design or Construction Defects

The contractor may indemnify the employer against any costs, expenses or damages resulting from defects in the design or construction of the project. This includes omissions, errors or failures to meet contractual specifications or industry standards, in accordance with Articles 663 and 665 of the Kuwait Civil Code.

Third-Party Claims

One party may agree to indemnify the other party against any actions, claims, demands or lawsuits brought by third parties related to the construction project. These are especially typical in instances where the performance of the contractor's obligations is delegated or utilises the work of third parties, and where the contractor assumes the responsibility of the third parties' actions and accordingly indemnifies the employer in accordance with Article 204 of the Kuwait Civil Code.

Intellectual Property Infringement

If the project involves the use of intellectual property, one party may indemnify the other party against any claims or damages arising from infringement of intellectual property rights, particularly pertaining to any unauthorised use of background and developed intellectual property.

Environmental/Regulatory Compliance

The contractor may indemnify the employer for any costs, fines or liabilities associated with non-compliance with environmental laws, regulations or permits during the course of the construction project.

Delay Claims

The contractor may indemnify the employer against any costs or damages resulting from delays and other disruptions caused by the contractor's actions or failures to perform according to the contract, in accordance with Article 293 of the Kuwait Civil Code.

7.2 Guarantees

In construction projects in Kuwait, the provision of guarantees can vary, and the subject is often governed by mandatory or regulatory laws, depending on the regulatory sector which the project involves. The following are some typical guarantees used in construction projects in Kuwait.

Performance Guarantees/Bonds

Issued by a bank, these guarantees ensure that the contractor will fulfil their contractual obligations, complete the project as specified and adhere to any expected industry quality standards. If the contractor fails to meet these obligations, the employer can make a claim against the bonds to recover losses.

Retention Guarantees

Also known as security deposits, these may be provided by the contractor to ensure their compliance with maintenance obligations or other imposed obligations after the completion of the project. These guarantees allow the employer to retain a certain percentage of the contractual value until the contractor fulfils their agreed-upon post-completion obligations.

Warranty Guarantees

These are typically provided by the contractor and/or the employer to ensure the quality and performance of the completed work or the equipment used and procured by either party. These guarantees protect the employer or the contractor from defects that may arise during the specified warranty period. If issues occur within the warranty period, the employer/contractor can claim against the guarantee for necessary repairs.

Payment Guarantees

These include payment bonds or guarantees issued by a bank or other financial institution, used by the employer as a form of ensuring that subcontractors, vendors/suppliers and other parties involved in the project will be paid for their services and materials.

Statutory Guarantees

Article 688 of the Kuwait Civil Code provides certain protections and guarantees that if, for any reason, the contract for work is terminated by an employer before completion, the contractor is entitled to compensation. This compensation includes:

- reimbursement for all expenses incurred;
- payment for the value of the work already executed; and

- the profit the contractor would have earned had the work been finished.

7.3 Insurance

Please refer to 7.1 Indemnities.

Other specific types of insurance policies provide coverage for certain aspects of the construction project. The following are some common types of insurance policies taken out in construction contracts in Kuwait.

Contractors' All-Risks Insurance (CAR)

This is a frequently secured insurance policy for contractors, offering protection against physical loss or damage to the construction project. It typically encompasses risks such as fire, theft, vandalism, natural disasters and accidental damage that may occur during the construction phase.

Professional Indemnity Insurance

This is often obtained by design professionals, including architects and engineers. It serves as a safeguard against claims that may arise from errors, omissions or professional negligence in the design or consulting services that the professionals provide.

Employers' Liability Insurance

This is commonly obtained by employers to protect themselves against legal liabilities in the case of workplace accidents, injuries or occupational diseases experienced by employees working on the construction project. This insurance provides compensation to employees affected by such incidents, and covers the associated legal expenses.

Delay in Start-Up (DSU) Insurance

This offers coverage for financial losses that the employer or the contractor may face due to

project start delays resulting from design errors, material supply disruptions or unforeseen circumstances.

7.4 Insolvency

In Kuwait, the specific contractual provisions regarding the consequences of insolvency in a construction contract may include the following.

Termination Rights

Construction contracts typically include provisions that allow the non-insolvent party to terminate the contract in the event of the other party's insolvency.

Step-In Rights

Some construction contracts may include provisions allowing the employer or another party to step in and take over the responsibilities of the insolvent party. This provision enables the project to continue despite insolvency.

Performance Bonds

Performance bonds or guarantees may provide financial security to the employer if the contractor becomes insolvent or fails to fulfil their contractual obligations. In the event of insolvency, the employer may have the right to make a claim against the performance bond to recover losses or secure an alternative means of completing the project.

Assignment of Claims

The contract may include provisions allowing the non-insolvent party to assign any claims or amounts owed by the insolvent party to a third party. This can help protect the non-insolvent party's interests and mitigate the financial impact of insolvency (in accordance with Article 680 of the Kuwait Civil Code).

7.5 Risk Sharing

Risk sharing is not regulated within the law per se; however, as in many other jurisdictions, the sharing of responsibility for certain risks is a common practice in Kuwaiti construction contracts. Generally, the distribution of risk between employers and contractors is influenced by the economic and market conditions prevailing during contractual negotiations. That said, some common risks often shared in construction contracts include the following.

Design Risk

Parties may allocate responsibility for design-related risks such as errors, omissions or inadequacies in the design documentation, which the employer typically bears when providing (eg, in FEED documentation) that the contractor bases their work and costs estimation for completing the project thereon.

Force Majeure Events

Construction contracts often contain provisions addressing force majeure events, and these provisions typically allocate the risk of such events between the parties, specifying which party will bear the additional costs or delays caused thereby. Article 233 of the Kuwait Civil Code limits liability for damages caused by force majeure events; however, Article 295 provides that parties may agree in advance to accept and/or limit liability for damages caused by force majeure events.

Delay and Liquidated Damages

Contracts commonly include provisions primarily placed on the contractor regarding delays extending beyond the agreed-upon timeframe. They may specify the precise calculation method and amount of liquidated damages that the party responsible for the delay must pay.

Site Conditions

Construction contracts typically address the risk of encountering unforeseen site conditions that may affect construction, with provisions usually placed on the employer for providing suitable site conditions.

8. Contract Administration and Claims

8.1 Personnel

Standard construction contracts commonly include provisions related to personnel, as can be observed in various contract templates such as the 1999 FIDIC Red Book. These provisions typically require contractors to:

- ensure that wages paid to their personnel are at least in line with industry standards;
- establish on-site medical staff, first aid facilities, a sick bay and ambulance services as available at all times; and
- implement necessary measures for welfare and hygiene to prevent epidemics.

The Labour Law

In addition, Kuwaiti Law No 6 of 2010 on Labour in the Private Sector (the “Labour Law”) contains dedicated provisions for construction workers, as follows.

Working hours

Articles 64 and 65 of the Labour Law stipulate that workers are prohibited from working for more than 48 hours per week or eight hours per day, except in specific cases as mentioned in the law. During the Holy Month of Ramadan, the working hours per week are reduced to 36.

Overtime

Article 67 of the Labour Law stipulates that overtime work should not exceed two hours per day, 180 hours per year, three days per week and 90 days per year. Workers have the right to provide evidence of being assigned extra work, or to receive overtime pay, which should be 25% higher than their regular pay for the same period.

Public holidays

Article 68 of the Labour Law stipulates that, if the work circumstances require the worker to work on any officially recognised public holiday, the worker has the right to receive double the regular remuneration for that day and should also be provided with another day off as compensation.

8.2 Subcontracting

In accordance with Articles 681 and 682 of the Kuwait Civil Code, possibilities exist under Kuwaiti jurisdiction in relation to subcontractors.

A contractor has the option of delegating the execution of all or part of the work to a subcontractor, unless the contract explicitly prohibits this or the nature of the work requires the contractor’s expertise. The involvement of a subcontractor does not absolve the principal contractor from their obligations towards the client or from their liability for the actions of the subcontractor.

In addition, when carrying out a contract, both the subcontractor and the workers employed by the principal contractor have the right to directly pursue legal action against the employer. However, their claims are limited to the extent of the amounts owed by the employer to the principal contractor at the time the legal action is filed. Similarly, the workers of the subcontractor may also take legal action against both the principal contractor and the employer, but only up to the amounts owed to them.

8.3 Intellectual Property

In Kuwait, intellectual property provisions in construction contracts typically address the ownership, use and protection of intellectual property rights related to the project, specifically the use of any background or developed intellectual property. These provisions specify the ownership of intellectual property and may grant licences or permissions for its use, including any measures to protect the intellectual property from unauthorised use or disclosure.

Construction contracts may also outline obligations for parties to take necessary steps in safeguarding intellectual property rights, and may include confidentiality agreements and non-disclosure clauses. Indemnification clauses are commonly included to protect against intellectual property infringement claims, and the transfer of intellectual property rights upon project completion is often addressed, including the transfer of ownership or usage rights to the employer or relevant parties.

It is also common for designers to provide collateral warranties to third parties (such as funders, purchasers and key tenants) where these warranties serve as a legal agreement between the designer and the third party, providing the third party with certain rights and protections in relation to the design of the project.

9. Remedies and Damages

9.1 Remedies

Please refer to **5.3 Remedies in the Event of Delays**.

The Kuwait Civil Code provides for parties involved in construction contracts to have a range of remedies at their disposal in the case

of a breach. Most commonly, damages can be sought to recover financial losses resulting from a breach, and specific performance may be pursued, whereby the non-breaching party requests that the breaching party fulfil their original contractual obligations.

Additionally, termination of the contract is an option in the event of a material breach, allowing the innocent party to cease their performance under the contract and possibly entitling them to seek damages for any losses suffered due to the breach. Another potential remedy is rectification, which involves requesting that the breaching party correct any defects in or non-conformance with the construction work, to align it with the agreed-upon contractual requirements.

9.2 Restricting Remedies

In Kuwait, it is not uncommon for parties to contractually limit the remedies available in construction contracts. Such limitations are generally permitted provided they are not in violation of any mandatory provisions of Kuwaiti law, and are freely negotiated and agreed upon by the parties.

However, certain statutory limitations on damages are included within the Kuwait Civil Code. Article 303 states that, if it can be proven that the “aggrieved” party did not suffer any damage, the agreed-upon damages shall not be payable. In addition, the court has the authority to reduce the amount of damages if it can be proven that the stipulated damages within the contract were greatly exaggerated or if the obligation has been partially fulfilled. Any agreement that contradicts these provisions is considered void.

In addition, according to Article 304, if the actual harm suffered exceeds the agreed-upon damages, the aggrieved party cannot claim an

increased amount unless they can provide evidence of fraud or serious misconduct.

9.3 Sole Remedy Clauses

In Kuwait, contractual sole remedy clauses are frequently used in construction contracts to limit the available remedies for a party in the case of a breach. While they are generally enforceable, there are instances where their enforceability may be challenged in Kuwaiti courts. Factors that may affect such enforcement include:

- unconscionability;
- fraud or misrepresentation;
- non-compliance with mandatory provisions; and
- the clear and unambiguous nature of the clause.

Enforcement of a contractual sole remedy clause is often subject to the interpretation of the competent court. If a sole remedy clause is found to be unconscionable, excessively unfair or contrary to public policy, a court may refuse to enforce it. Similarly, if a party can demonstrate that the other party fraudulently induced them into agreeing to the clause or made material misrepresentations, the clause may be deemed void.

9.4 Excluded Damages

In Kuwaiti construction contracts, the exclusion or limitation of liability for certain types of damages is a common practice. The specific forms of damages typically excluded can vary based on the terms negotiated between the parties. However, there are several common types of damages that are often excluded or limited in such contracts.

For example, consequential damages, which are indirect or special damages resulting from the

breach, are commonly excluded or limited, as they do not exist and therefore are not enforceable under applicable Kuwaiti law.

In addition, punitive damages, which aim to punish the breaching party for their misconduct, are generally excluded. Such damages extend beyond compensating for actual losses and are not usually permitted under Kuwaiti law; by excluding punitive damages, the focus remains on compensating the injured party rather than on seeking punishment.

9.5 Retention and Suspension Rights

Generally, for foreign entities contracting with local entities in Kuwait, the paying entity is required to withhold 5% from each payment or the total contract value until the recipient provides a valid tax retention release letter (RRL) issued by the Ministry of Finance (MOF). The RRL is granted by the MOF when it is convinced that the taxpayer has fulfilled their tax obligations in Kuwait or qualifies for tax exemption.

9.6 Termination

The Kuwait Civil Code provides for possibilities where a construction contract may be terminated, as follows:

- a contract for work terminates when the specified period for maintenance or additional work expires (Article 684);
- the contract terminates if the performance of the work becomes impossible due to reasons beyond the control of either party (Article 685);
- the death of the contractor automatically terminates the contract if the contractor's personal qualifications or skills were considered in the contract (Article 687); and
- the employer has the right to terminate the contract at any time before completion,

provided they compensate the contractor for expenses, the value of work completed and the expected profit upon completion (Article 688).

10. Dispute Resolution

10.1 Regular Dispute Resolution

Commercial circuit courts are usually regarded as the most competent courts in Kuwait to adjudicate on construction dispute matters.

In the majority of claims related to construction disputes, the trial judge would likely refer the case to an expert from the Ministry of Justice to investigate technical matters of the claim, as the expert would possess the necessary technical expertise and knowledge to assist the judge in reaching a well-informed judgment. The expert is often assigned broad responsibilities, including:

- determining rights and obligations;
- assessing breaches of obligations;
- evaluating defences; and
- determining the extent of damages suffered, if any.

However, the legal aspects of the dispute remain within the judge's deliberation.

10.2 Alternative Dispute Resolution

Kuwait has long recognised the significance of arbitration and has sought to incorporate it into its legal framework, particularly due to the growing importance of arbitration and the expansion of international and local business activities in Kuwait (see Kuwaiti Law No 11/1995 on Judicial Arbitration with Respect to Civil and Commercial Matters, which was enacted to address the evolving needs in this area).

Said law aimed to provide comprehensive coverage of arbitration requirements, authorising the establishment of the Kuwait Commercial Arbitration Centre (KCAC) in 1999 with the primary goal of promoting arbitration as a means of resolving commercial disputes, and which was established to facilitate a flexible and efficient arbitration procedure in Kuwait.

MALAYSIA

Law and Practice

Contributed by:

Lim Siaw Wan and Chris Tan
Christopher & Lee Ong



Contents

1. General p.382

- 1.1 Governing Law p.382
- 1.2 Standard Contracts p.382

2. Parties p.383

- 2.1 The Employer p.383
- 2.2 The Contractor p.384
- 2.3 The Subcontractors p.384
- 2.4 The Financiers p.385
- 2.5 The Designer p.385

3. Works p.386

- 3.1 Scope p.386
- 3.2 Variations p.386
- 3.3 Design p.387
- 3.4 Construction p.387
- 3.5 Site p.387
- 3.6 Permits p.388
- 3.7 Maintenance p.388
- 3.8 Other Functions p.388
- 3.9 Tests p.389
- 3.10 Completion, Takeover and Delivery p.389
- 3.11 Defects and Defects Liability Period p.389

4. Price p.390

- 4.1 Contract Price p.390
- 4.2 Indexation p.390
- 4.3 Payment p.391
- 4.4 Invoicing p.392

5. Time p.392

- 5.1 Planning and Programme p.392
- 5.2 Delays p.392
- 5.3 Remedies in the Event of Delays p.393
- 5.4 Extension of Time p.393
- 5.5 Force Majeure p.394
- 5.6 Unforeseen Circumstances p.394
- 5.7 Disruption p.394

6. Liability p.395

- 6.1 Exclusion of Liability p.395
- 6.2 Wilful Misconduct and Gross Negligence p.395
- 6.3 Limitation of Liability p.395

7. Risk, Insurance and Securities p.395

- 7.1 Indemnities p.395
- 7.2 Guarantees p.395
- 7.3 Insurance p.396
- 7.4 Insolvency p.396
- 7.5 Risk Sharing p.396

8. Contract Administration and Claims p.397

- 8.1 Personnel p.397
- 8.2 Subcontracting p.397
- 8.3 Intellectual Property p.398

9. Remedies and Damages p.398

- 9.1 Remedies p.398
- 9.2 Restricting Remedies p.399
- 9.3 Sole Remedy Clauses p.399
- 9.4 Excluded Damages p.399
- 9.5 Retention and Suspension Rights p.399
- 9.6 Termination p.399

10. Dispute Resolution p.400

- 10.1 Regular Dispute Resolution p.400
- 10.2 Alternative Dispute Resolution p.400

Christopher & Lee Ong (CLO) is a member firm of Rajah & Tann Asia, one of the largest full-service Association of South-East Asian Nations legal networks, with access to a network of law firms across South-East Asia with more than 1,000 fee earners, including in Cambodia, China, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam. CLO's construction and projects practice group is one of the leading practices in Malaysia, housing a team of lawyers with extensive experience in a wide range of projects, including energy and resources, infrastructure, water, oil and gas instal-

lations, airports, highways and toll roads, ports, tunnels, rail systems, sewerage systems, mines and mineral processing facilities. CLO is well-versed with the numerous agreements involved in projects such as concession agreements, power purchase agreements (PPA), construction agreements, design and build contracts, engineering, procurement and construction contracts, operation and maintenance agreements, engineering and consultancy agreements, service agreements, and the standard forms of contract adopted in Malaysia.

Authors



Lim Siaw Wan is a partner in Christopher & Lee Ong's projects and infrastructure practice group, specialising in front-end construction and project development work. She has worked in the projects space for more than 15 years and has amassed considerable experience in areas such as data centres, power projects, renewable energy projects and infrastructure (including rail, roads/highways, and telecommunications). Siaw Wan is recognised and listed in established legal directories as a leading individual in project development covering multiple industries, including construction and materials, energy, oil and gas, and transportation. She is a member of the Bar Council of Malaysia and the Kuala Lumpur Bar and the Honourable Society of Lincoln's Inn.



Chris Tan is a senior associate in Christopher & Lee Ong's projects and infrastructure practice group. Chris focuses on various matters relating to energy (conventional and renewable), projects and infrastructure, and construction and property development. He also regularly advises on issues relating to project documents and management, including issues relating to extension of time, delay and performance liquidated damages, bank guarantees, environmental law and occupational health issues. Chris' experience further extends to arbitration, adjudication, and court litigation, and he has appeared at all levels of courts in Malaysia. Chris is a member of the Bar Council of Malaysia, the Kuala Lumpur Bar and the Honourable Society of Middle Temple.

Christopher & Lee Ong

Level 22 Axiata Tower
No 9 Jalan Stesen Sentral 5
Kuala Lumpur Sentral
50470 Kuala Lumpur
Malaysia

Tel: +603 2273 1919
Fax: +603 2273 8310
Email: clo-info@christopherleeong.com
Web: www.christopherleeong.com

CHRISTOPHER & LEE ONG

1. General

1.1 Governing Law

The construction market is generally governed by the laws of Malaysia, which include the statutes enacted as well as the case laws.

The main legislation relevant to construction contracts includes:

- the Contracts Act 1950; and
- the Construction Industry Payment and Adjudication Act 2012 (CIPAA).

There are also statutes relating to the planning of and actual works, including:

- the Occupational Safety and Health Act 1994;
- the Street, Drainage and Building Act 1974;
- the Town and Country Planning Act 1976;
- the Uniform Building By-Laws 1984;
- the Environmental Quality Act 1974; and
- the Construction Industry Development Board Act 1994.

The statutes above can be found on the [Federal Legislation website](#). Some statutes may be applicable in Peninsular Malaysia only.

1.2 Standard Contracts

The use of standard form construction contracts is quite common, albeit not mandatory. A few types of standard form construction contracts used in Malaysia are discussed below.

PAM Contracts

PAM is short for *Pertubuhan Akitek Malaysia* (Malaysian Institute of Architects). PAM contracts are build-only contracts under which the architect is the contract administrator. PAM has published several standard form contracts, as follows.

- For use between employer and main contractor:
 - (a) PAM Contract 2018 (With Quantities);
 - (b) PAM Contract 2018 (Without Quantities);
 - (c) PAM Contract 2006 (With Quantities); and
 - (d) PAM Contract 2006 (Without Quantities).
- For use between main contractor and sub-contractor:
 - (a) PAM Sub-Contract 2018; and
 - (b) PAM Sub-Contract 2006.

FIDIC Contracts

International employers and/or contractors may prefer to use the International Federation of Con-

sulting Engineers (*Fédération Internationale des Ingénieurs-Conseils*, or FIDIC) suite of contracts due to their familiarity with the FIDIC contracts, which are administered by engineers. The type of FIDIC contract used will depend on the nature of the project. The more commonly seen FIDIC contracts in Malaysia include the Red Book (Construction Contract), the Silver Book (EPC/Turnkey Contract) and the Yellow Book (Plant and Design-Build Contract).

PWD Contracts

Standard form contracts published by the Public Works Department of Malaysia (PWD) are commonly used in government-related projects in Malaysia. PWD contracts are administered by the superintending officer.

PWD contracts used between employer and main contractor are:

- PWD Form 203 (where drawings and specifications form part of the contract);
- PWD Form 203A (where bills of quantities form part of the contract); and
- PWD Form DB (for design and build).

PWD Form 203N is used between the main contractor and nominated subcontractor where the main contract uses PWD Form 203 or PWD Form 203A. PWD Form 203P is used for the engagement of nominated supplier in conjunction with PWD Form 203A.

Other Standard Form Contracts

Other standard form contracts used in projects in Malaysia (albeit less frequently than the above-mentioned contracts) include:

- standard form contract for building works by the Construction Industry Development Board (CIDB);

- standard form contracts for engineering works by the Institute of Engineers Malaysia (IEM); and
- standard form contracts for building works/design-and-build works by the Asian International Arbitration Centre (AIAC).

2. Parties

2.1 The Employer

General

Employers in construction projects in Malaysia vary depending on the nature of such projects. In public projects, the employer can be either the federal or state government, a statutory body or a government-linked company. On the other hand, in private projects, the employer can be a public limited company, a private limited company, or an incorporated or unincorporated joint venture/consortium or partnership.

Rights and Obligations

The rights and obligations of the employer vary depending on the nature of the projects and the type of construction contract adopted.

Generally, the employer has the right to receive the completed project or works based on the designs and specifications provided within the stipulated timeline. In return, the employer has obligations to make payments and to provide site access in accordance with the contract. The employer is also under a general obligation not to prevent the contractor from performing the contractor's obligations. In build-only projects, the employer will also provide the design of the building or plant to be constructed.

Relationship between employer and contractor

The relationship between the employer and the contractor is normally of a contractual nature and is governed by the construction contract.

Relationship between employer and subcontractor

In most cases, the contracting structure is such that the employer will not have any contractual relationship with the subcontractor, and this is expressly specified in the main contract. The contractor will usually be liable for all acts and omissions of the subcontractor. This is the most preferred way of contracting for ease of project management, as – from the employer’s risk perspective – there is a single point for responsibility.

Relationship between employer and financiers

The relationship between the employer and the financiers is usually governed by the financing documents. The financiers are not usually party to the construction contract, but they may request certain financiers’ rights to be included, such as assignment of certain rights or interests under the contract to the financiers. In project financing, there are requirements for the parties to enter into direct agreements with the financiers in order to allow these financiers certain rights under the construction contracts, in case of default.

2.2 The Contractor

General

Contractors in construction projects in Malaysia vary depending on the nature of such projects. They can be a public limited company, a private limited company, or an incorporated or unincorporated joint venture/consortium or partnership.

Rights and Obligations

The rights and obligations of the contractor vary depending on the nature of the projects and the type of construction contract adopted.

The contractor will be under the obligation to carry out the works in a timely manner in accordance with requirements under the contract. In design-and-build projects, the contractor usually will also provide the design of the building or plant to be constructed based on certain requirements/specifications provided by the employer.

In return, the contractor will be entitled to timely payment in accordance with the contract.

Relationship between contractor and employer

See 2.1 The Employer.

Relationship between contractor and subcontractor

The relationship between the contractor and the subcontractor is normally of a contractual nature and is governed by the subcontract. See **2.1 The Employer** for more on the contractor’s liability to the employer for all acts and omissions of the subcontractor.

Relationship between contractor and financiers

In Malaysia, the contractor does not normally have financiers for the project. If financing is required, the relationship will be governed by the financing documents.

2.3 The Subcontractors

General

Subcontractors in construction projects in Malaysia vary depending on the nature of the subcontract works to be carried out, and can be a public limited company, a private limited com-

pany, or an incorporated or unincorporated joint venture/consortium or partnership. Subcontractors are normally engaged to provide works in specialised areas. See 8.2 Subcontracting for further details.

Rights and Obligations

The rights and obligations of the subcontractor are governed by the subcontract. The subcontractor will not have rights under the construction contract, owing to lack of privity of contract, unless it is made a contracting party.

Under the subcontract, the subcontractor will have the obligation to carry out the subcontract works in a timely manner in accordance with requirements under the subcontract. In return, the subcontractors will be entitled to timely payment in accordance with the subcontract.

Relationship between subcontractor and employer

See 2.1 The Employer.

Relationship between subcontractor and contractor

See 2.2 The Contractor.

Relationship between subcontractor and financiers

In Malaysia, the subcontractor does not normally have financiers for the project. If financing is required, the relationship will be governed by the financing documents.

2.4 The Financiers

General

Financiers in construction projects in Malaysia are typically financial institutions or banks.

Rights and Obligations

The rights and obligations of the financiers are governed by the financing documents and the financiers will not have rights under the construction contract, owing to lack of privity of contract – except for any rights expressly included in the contract, such as assignment of certain rights or interests under the contract to the financiers.

Relationship between financiers and employer

See 2.1 The Employer.

Relationship between financiers and contractor

See 2.2 The Contractor.

Relationship between financiers and subcontractor

See 2.3 The Subcontractors.

2.5 The Designer

General

In build-only projects, the designer is typically the consultant/consultancy company engaged separately by the employer, or the designing works can be done in-house by an engineer or architect within the employer.

In design-and-build projects, the contractor will undertake the role of the designer.

Rights and Obligations

In build-only projects, the rights and obligations of the designer are governed by a separate agreement between the employer and the designer, and the designer will not have rights under the construction contract owing to lack of privity of contract.

In design-and-build projects, as the contractor is the designer, the contractor will provide the

design of the building or plant to be constructed in accordance with the contractual requirements. See **2.2 The Contractor**.

Relationship between designer and employer

The relationship between the designer and the employer is normally of a contractual nature and is governed by a separate agreement or the construction contract, depending on the nature of the project.

Relationship between designer and contractor

In build-only projects, typically the designer will not have any contractual relationship with the contractor. However, in design-and-build projects, the designer is the contractor.

3. Works

3.1 Scope

Generally, the scope of works in a construction contract is set out in the documents forming the contract. These contract documents may include:

- conditions of contract;
- employer's requirements/specifications;
- tender documents;
- drawings;
- bills of quantities; and
- contractor's proposal.

3.2 Variations

Scope for Variations

The scope for variations is typically determined in accordance with the relevant variation provisions in the construction contract. Construction contracts will typically provide for:

- definition of variation (including any addition, alteration or omission to the contractor's initial scope of works);
- the process of requesting or instructing variation – variation is usually effected through a variation order;
- the presentation of a variation proposal by the contractor;
- the valuation procedures and methodology;
- adjustment to contract price; and
- extension of time (EOT) and/or prolongation cost claims due to variation.

Price for Variations

The price for variations is established based on the contractual provisions setting out the method of valuation. Depending on the character and conditions of the variation, the value of the variation may be calculated based on the stipulated rates and prices in the construction contract, fair market rate or "daywork rates" basis.

In the event of omission of work, valuation will normally be done by referring to the rates or prices provided in the contract, as the omission will be on an existing scope with an agreed rate/price. The value of the omission will be deducted from the contract price.

Some standard form contracts contain valuation mechanisms from which parties can take guidance, as follows.

- PWD Form 203A – the valuation of the variation is primarily based on the rates provided in bills of quantities. If the variation work cannot be properly measured or valued, the value of variation will be determined based on the actual net cost incurred by the contractor for the materials, plant and labour for the work plus 15%.

- PWD Form 203 – if the work involves the addition of the whole of any similar item of work and is executed under similar conditions as work priced in the summary of tender, such price in the summary of tender shall be the basis of valuation. The valuation of the other types of variation works, including omission, is primarily based on the rates provided in the schedule of rates. If the variation work cannot be properly measured or valued, the value of the variation will be determined based on the actual net cost incurred by the contractor for the materials, plant and labour for the work plus 15%.
- PAM Contract 2018 – the variation work shall be measured and valued by the quantity surveyor (With Quantities) or the architect (Without Quantities). The valuation of variation work (including any omission) is primarily based on the rates and prices set out in the contract documents, with fair adjustments to be made if the work is not executed under similar conditions or in a similar quantity. Fair market rates and prices determined by a quantity surveyor or an architect will apply if the work is not of a similar character to those set out in the contract documents. Where the works cannot be properly measured and valued in the preceding ways, the contractor will be entitled to either the daywork rates in the contract documents or – if no such daywork rates are available – the actual cost incurred by the contractor for the materials, additional construction plant and scaffolding, transport and labour plus 15%.

Where the construction contract is silent on the valuation for variation, parties may rely on the following.

- Section 36 of the CIPAA – the value shall be calculated based on fees prescribed by the

relevant regulatory body under the law and, where there are such no prescribed fees, valuation shall be made based on rates prevailing in the construction industry at the time of the carrying out of the construction work.

- Quantum meruit – Section 71 of the Contracts Act 1950 allows the contractor to be compensated a reasonable sum for the variation works done.
- Settlement discussion – parties are free to negotiate and agree on price for variations.

Time/Cost Impact of Variation

Where the variation causes delay to the completion of the works that is not due to any acts/omissions by the contractor, the contractor may be entitled to EOT for the completion of the works. Depending on the parties' agreement reflected in the contract, the contractor may also be entitled to costs for the delay.

3.3 Design

The responsibilities for the design vary depending on the nature of the construction project. See **2.5 The Designer** for further details.

3.4 Construction

In most construction projects, the contractor will undertake the construction works under the construction contracts. The employer and/or the contract administrator/consultant usually assume a supervisory role regarding the works.

If the contractor subcontracts some works under the construction contract to the subcontractor, the subcontractor will carry out a portion of the construction works.

3.5 Site Site Access

One of the employer's main obligations under a construction contract is usually the provision

of site access for the contractor and/or subcontractor to carry out the works. The contract may provide for certain restrictions/limitations to such access, or access may be given in stages based on the works to be carried out.

Site Conditions

A construction contract will typically contain provisions regarding the site conditions. The contractor is usually required to warrant that it has studied/inspected and has satisfied itself of the site conditions for the purposes of performing its obligations under the contract and that it would have no claims against the employer arising from or in connection with any site conditions.

Pollution

On the issue of pollution, parties under the construction contract are required to comply with the applicable laws (including the Environmental Quality Act 1974, which contains provisions prohibiting any pollution of soil, surface of land, water, etc).

Archaeological Finds

For archaeological finds such as fossils or antiquities on site, the construction contract will normally provide that the ownership of such items vests in the employer, and the contractor has certain obligations arising from the finds (such as preservation and notification to the employer/contract administrator). Apart from the contractual terms, the National Heritage Act 2005 requires – among other things – the person who discovers at the site any object with cultural heritage significance to report such discovery to the Commissioner of Heritage, authorised officer or district officer.

3.6 Permits

Generally, the permits or approvals required for construction are governed by the Street,

Drainage and Building Act 1974, the Uniform Building By-Laws 1984 and the Environmental Quality Act 1974, which include planning permission, building plan approval, and development order, fire safety plan and environmental impact assessment approval. The construction contract will typically place the obligation to obtain any permits/approvals on the party carrying out the works (ie, the contractor). If certain permits/approvals need to be applied in the name of the employer, the contractor will usually have an obligation to assist the employer with such applications.

Further, unless exempted, the contractor and subcontractors (whether local or foreign) will need to be registered with the CIDB before undertaking any construction works in Malaysia, pursuant to the Construction Industry Development Board Act 1994.

3.7 Maintenance

Prior to completion of the construction works, the construction contract typically provides that the contractor is responsible for the maintenance and protection of the works, including the permanent works, temporary works, materials, goods, equipment and machinery on site.

Post-completion, the completed works will be handed over to the employer. The construction contract will not typically provide for maintenance post-completion, apart from the contractor's obligations in relation to defects within the defects liability/warranty period. The employer may by itself maintain the completed works or it may enter into a separate maintenance agreement with the contractor or a third party.

3.8 Other Functions

It is not common for the employer in Malaysia to instruct the contractor on other functions in the

construction process such as operation, finance and transfer. These scopes of work are usually undertaken either by the employer themselves or by third parties separately engaged by the employer.

3.9 Tests

Generally, the contractor has the responsibility to carry out the tests in accordance with the construction contract. The employer's requirements/specifications will typically set out the tests that need to be done by the contractor, including the tests for completion. The contractor usually bears its own costs and expenses for the tests (including any re-tests), as these would have been priced into the contract price.

The typical process for tests for completion is as follows:

- notification by the contractor to the employer/contract administrator when the works are ready for test for completion;
- the employer/contract administrator may have a right to be present to observe the test;
- the contractor shall carry out the test for completion (including any re-testing) until the test has been successfully passed; and
- the contractor shall then provide the test report to the employer/contract administrator.

3.10 Completion, Takeover and Delivery

Typically, once the constructions works have been practically completed in accordance with the requirements of the construction contract, the contractor will notify the employer/contract administrator to inspect the works to determine if the works have achieved practical completion.

If the works have any deficiency, it would be notified to the contractor and the contractor will fix such deficiency before the process of

notification and inspection is repeated until the employer/contract administrator is satisfied that the works have achieved practical completion.

Following that, the employer/contract administrator will issue a certificate certifying the practical completion of the works, typically known as the "Certificate of Practical Completion" or the "Taking Over Certificate".

The works are normally handed over and delivered by the contractor to the employer on the date stated in the certificate issued. The certificate may contain a punch-list of minor items that do not affect the operation or use of the works but need to be completed by the contractor within a specified period. Upon handover, the contractor may be entitled to certain payments and the defects liability period (DLP) will commence.

3.11 Defects and Defects Liability Period

Upon the taking over of the completed works by the employer, the DLP will commence for a period agreed by the parties in the construction contract. The DLP typically ranges from 12 to 36 months, depending on the type and complexity of the works. During the DLP, the contractor is obliged to make good any defects in the works. The contract may provide rights for the employer to make good the defects itself or by engaging a third party (under certain circumstances such as the failure of the contractor to make good defects within a reasonable time) at the contractor's cost.

Upon expiry of the DLP and making good of all identified defects, the employer will issue a certificate (typically known as the "Certificate of Making Good Defects" or "Final Completion Certificate") and the contractor will be entitled to a final payment under the contract.

Depending on the nature of the projects, the construction contract may provide separate obligations for the contractor vis-à-vis endemic defects, which normally involve significant defects or failure in the design. Such obligations are more commonly seen in contracts under which the contractor is responsible for the design.

Sometimes, a separate DLP will be provided for the contractor's obligations on latent defects (ie, defects that are not reasonably capable of being discovered prior to the expiry of the usual DLP).

Unless otherwise agreed by the parties, the provisions concerning defects and the DLP and any remedies provided in the construction contract will not normally limit the other causes of action or remedies available to the employer, including recovery of damages for breach of contract or tort.

4. Price

4.1 Contract Price

In Malaysia, the contract price of a construction contract is usually established in one of the following ways.

- Fixed lump sum contract – the contract price will be a fixed amount (subject to adjustments allowed under the contract, such as variation or EOT) for the contractor to perform all its obligations under the contract.
- Measure and value/remasurement contract – the contract price provided is an indicative amount that is subject to the measurement and valuation of the actual works carried out by the contractor. The measurement and valuation will be based on an agreed mechanism under the contract, normally calculated

based on the bills of quantities and/or schedule of rates.

Milestone payments are commonly used in projects where there are identifiable major milestones to be achieved by the contractor. Otherwise, if there is no clear milestone set out in the contract, the interim payment mechanism is more commonly used.

4.2 Indexation

Indexation of prices is not commonly seen in construction contracts in Malaysia. The allocation of risks, including the risk of price fluctuations, is usually agreed to between the parties when they enter into the contract. However, nothing prohibits the parties from agreeing otherwise and if there is going to be any adjustment of the contract price due to this, it must be express.

Some instances of how construction contracts deal with the fluctuation of prices can be seen in standard form contracts, as follows.

- Under both PWD Form 203A and PWD Form 203, any adjustment to the contract price due to fluctuation upwards and/or downwards will have to be expressly agreed between the parties in the special provisions.
- Under both PAM Contract 2018 (With Quantities) and PAM Contract 2018 (Without Quantities), the contract price shall not be adjusted in any way other than in accordance with the express provisions in the contract. Therefore, in the absence of specific clauses allowing the adjustment of the contract price on the ground of price fluctuations, any associated risks will be borne by the contractor.
- Under the FIDIC Yellow Book, adjustments of payment for changes in costs will only be allowed if a schedule of cost indexation is

included in the contract; otherwise, the contract price will be deemed to have included amounts to cover the contingency of rises and falls in costs.

- Under the FIDIC Red Book and Pink Book, adjustments for rises or falls in the costs of labour, goods and other inputs to the works will be determined by the formulae prescribed in the contract by using the cost indices and reference prices in the table of adjustment data; otherwise, the contract price will be deemed to have included amounts to cover the contingency of rises and falls in costs.

4.3 Payment

Advance Payment

Some construction contracts provide for advance payment to the contractor, which normally means that the contractor will receive the payment before it commences the works. This mechanism is typically used to ease the cash flow or financial burden on the contractor to fork out enough financing to carry out the works up to the first payment under the contract.

If there is advance payment, the contractor will be required to provide a bank to secure the repayment of such advance payment. The advance payment is normally repaid through percentage deductions by the employer on the interim/milestone payments.

Interim Payment

If the construction contract provides for interim payment mechanism, typically this means that the contractor will submit a payment application/claim on a regular and fixed interval basis, such as monthly or quarterly.

The employer/contract administrator will inspect and review the payment application/claim submitted and the progress of the works to deter-

mine the amount of payment that the contractor is entitled to in accordance with the contract, which will normally be recorded in an interim payment certificate. The employer will then pay the contractor the amount recorded in the interim payment certificate within the period provided in the contract.

Milestone Payment

The milestone payment mechanism typically works in the same way as the interim payment mechanism, except that the contractor will only make the payment application/claim upon achievement of a milestone set out in the contract. Each milestone will normally be tagged to a percentage of the contract price.

Delayed Payment/Non-Payment

Some construction contracts may provide for late payment interest. In the absence of such provisions, the contractor is normally not contractually entitled to any late payment interest. Notwithstanding the foregoing, the courts in Malaysia (under Section 11 of the Civil Law Act 1965), arbitral tribunals (under the relevant arbitration rules such as the AIAC Arbitration Rules) and adjudicators (under the CIPAA) are empowered to award late payment interest at a rate to be determined in the event the contractor is successful in its claims against the employer for breach of contract through one of the dispute resolution mechanisms detailed in **10.1 Regular Dispute Resolution** and **10.2 Alternative Dispute Resolution**.

For court proceedings, the contractor may also rely on Order 42 rule 12 of the Rules of Court 2012 to claim post-judgment interest from the date of judgment until the date when the judgment is satisfied, either at the rate expressly provided for in the construction contract or at the

rate determined by the Chief Justice from time to time (currently 5% per annum).

4.4 Invoicing

The need for invoicing is typically agreed between the parties in the construction contract and will be issued in accordance with the payment provisions in the contract. Invoices will be issued by the contractor to the employer following the issuance of the interim payment certificate. Payments will be made within a period upon the receipt of the invoice by the employer.

5. Time

5.1 Planning and Programme

The process of planning and preparing the programme is usually governed by the relevant provisions in the construction contract. It is possible that a finalised programme is agreed at the time of signing the contract and therefore no specific planning procedures would be set out in the contract. Otherwise, the process of planning will be a requirement under the contract and the responsibility typically lies with the contractor to plan and prepare the programme, which needs to be updated from time to time throughout the construction period to reflect the actual progress of the works on site.

The programme will typically contain the sequence in which the contractor will carry out the works, detailed activities of the works, and the methods of construction to be adopted by the contractor. The programme is usually subject to the review and approval of the employer/contract administrator. If the programme is required to be revised owing to any delay in the progress of the works, the revised programme will usually also contain measures to mitigate the delay or to accelerate the works.

The construction contract normally provides that the programme does not form part of the contract/is not binding but is used as a planning tool to measure and monitor the progress of the works. Sometimes, the programme will be used as a basis to assess any delay and EOT.

5.2 Delays

Generally, the construction contract will provide for mechanisms to deal with delays in the works. The applicable mechanism may differ depending on the cause of the delay.

Employer's Delay

For delay caused by the employer, the contract will normally provide for an EOT mechanism, which extends the scheduled completion date. There may be certain notice and/or claim requirements imposed on the contractor to be entitled to EOT.

The time-related costs suffered by the contractor owing to the employer's delay will usually be claimed together with the EOT and are subject to assessment by the employer/contract administrator.

Contractor's Delay

For delay caused by the contractor, the contractor will usually not be entitled to any EOT. It is common for the contract to provide liquidated damages provisions if the contractor fails to achieve completion and/or certain milestones on or before the scheduled date(s) provided in the contract. The liquidated damages are typically calculated at a daily rate for each day of delay up to the achievement of completion or the relevant milestone. The employer's entitlement to liquidated damages may be subject to the issuance of a certificate of non-completion/default.

Other Delay

There may be other causes of delay, which are not attributable to either party, such as a force majeure event. The parties will usually agree to the allocation of risks in relation to such delays in the contract. By way of example, it is common for the parties to share the risk of delay caused by force majeure events by allowing the contractor to claim EOT but not allowing claims for time-related costs.

Concurrent Delay

It is not uncommon for concurrent delay to occur in construction works (ie, two or more overlapping causes of delay have caused delay in the works). Sometimes, the contract will provide for the allocation of risks relating to concurrent delay.

If there is no such provision in the contract, the treatment of concurrent delay by the court or the arbitral tribunal will vary from case to case, depending on the factual circumstances. However, generally, the court or arbitral tribunal is minded to award some EOT to the contractor if it is proven that the employer has contributed to the delay.

5.3 Remedies in the Event of Delays

The remedies available to the employer in the event of delays will depend on the construction contract. Remedies available to the employer include the following.

- Liquidated damages payable by the contractor to the employer calculated at a daily rate for each day of delay up to the achievement of completion or the relevant milestone – see **5.2 Delays**. Most construction contracts that contain liquidated damages provisions will provide for a cap on the amount of liquidated damages for which the contractor will be

liable. Once the liquidated damages accumulate up to the cap amount, this may give rise to a right of termination of the construction contract by the employer.

- Termination of the contract for breach of contract – see **9.6 Termination**.
- The option to step-in and undertake the works itself or engage a third party to complete the works – if such remedy is exercised by the employer, the employer may have recourse on the contractor for the additional costs incurred by setting off such costs against any payment due or any retention money under the construction contract or by making a demand on any available bank guarantee.

5.4 Extension of Time

See **5.2 Delays**. The relevant delay events that may entitle the contractor to EOT will normally be set out or defined in the contract. Such events may include:

- any acts of prevention by the employer, such as delay in granting site access, delay in approval/supply of drawings, and delay in giving instructions;
- variation of the works; and
- force majeure events.

Typically, when a relevant delay event occurs, the contractor will be required to notify the employer/contract administrator and submit an application for EOT. The contractor may be required to prove that it has reasonably mitigated the delay and/or submit sufficient documents to show that the delay falls on the critical path and has actually delayed the scheduled completion date. The submission of notice and/or claim may be made mandatory in the contract. Some contracts may provide that any failure to comply with such

requirements will be deemed to be a waiver by the contractor of any entitlement to EOT.

Once sufficient documents have been submitted, the employer/contract administrator will assess the application and – if it is of the view that the contractor is entitled to any EOT – the employer/contract administrator will normally be required to issue a certificate of EOT recording the EOT granted and the new scheduled completion date.

5.5 Force Majeure

General

In Malaysia, force majeure is a purely contractual concept that must be expressly provided for in the contract otherwise it will not be implied into the contract.

The events constituting force majeure will typically be defined in the contract. Generally, force majeure is defined in one of the following ways.

- Non-exhaustive definition – this provides general criteria for an event to qualify as force majeure, such as events that are beyond the reasonable control of parties, not reasonably foreseeable at the time of the contract and not attributable to either party. Examples of events may be provided but are not intended to limit potential force majeure events. Events excluded from qualifying as force majeure may also be provided.
- Exhaustive definition – this provides for an exhaustive list of events that can qualify as force majeure. Any events not listed will not be recognised as force majeure.

Common force majeure events are war, riots, embargo, natural disasters, industrial strikes or other labour disputes, pandemics, and the like.

Consequences of Force Majeure

The consequences of force majeure are normally agreed by parties to the contract and typically include:

- the affected party being relieved from performing its contractual obligations for the period when the force majeure is subsisting, without liability to the other party;
- the affected party must reasonably mitigate the effect of force majeure; and
- if the affected party is the contractor, the contractor may be entitled to EOT (see 5.2 Delays and 5.4 Extension of Time).

5.6 Unforeseen Circumstances

Generally, the allocation of the risks of unforeseen circumstances will be negotiated and agreed upon by the parties in the construction contract. If the contract does not provide for the rights and obligations upon the occurrence of unforeseen circumstances, and such unforeseen circumstances have rendered the contract impossible to be performed or otherwise frustrated, the contract will become void pursuant to Section 57(2) of the Contracts Act 1950. Upon frustration of the contract, the rights and liabilities of the parties will include:

- recovery of the sums paid and/or valuable benefit obtained pursuant to Sections 15 and 16 of the Civil Law Act 1956; and
- restoration of or compensation for any advantage received under the contract pursuant to Section 66 of the Contracts Act 1950.

5.7 Disruption

In Malaysia, most construction contracts do not expressly deal with disruption in general terms as a ground for EOT and/or compensation. Depending on the nature and extent of the disruption, it may fall within the ambit of

variation or employer's act of prevention, which may entitle the contractor to claim EOT and/or compensation; otherwise, the contractor may have recourse for additional costs incurred by recovering such costs as general damages if the disruption amounts to a breach of contract by the employer.

6. Liability

6.1 Exclusion of Liability

Exclusion of liability is not as common as limitation of liability in construction contracts. Section 29 of the Contracts Act 1950 prohibits an absolute restriction on a party from enforcing any rights under the contract.

Section 14(2) of the Civil Law Act 1956 provides that any provision in a contract of service or apprenticeship having the effect of excluding or limiting an employer's liability for personal injuries caused by negligence is void. This applies to employment contracts between a party and its personnel but is likely not applicable to construction contracts. Construction contracts typically have fault-based indemnity clauses relating to death or personal injury. See **7.1 Indemnities**.

6.2 Wilful Misconduct and Gross Negligence

The concepts of "wilful misconduct" and "gross negligence" exist under common law and have been interpreted by the courts in Malaysia. They are not fixed and their scope may differ from case to case based on the factual circumstances. Therefore, it is not uncommon for parties to agree to certain definitions of wilful misconduct and gross negligence in the construction contract in order to have more certainty concerning what these concepts entail.

6.3 Limitation of Liability

Construction contracts in Malaysia typically provide for limitation of liability clauses, such as:

- liquidated damages being capped at a percentage of the contract price;
- the contractor's maximum liability under the contract being capped at a percentage of or the amount of the contract price; and
- limitation on damages recoverable under the contract to only direct loss and damage.

7. Risk, Insurance and Securities

7.1 Indemnities

It is common for the construction contract to provide for indemnity by a party to another party for:

- any damage to property (including third party's property) or personal injury (including death) caused by the act or omission of the indemnifying party; and
- any claims by third party (including indemnifying party's employee) against the indemnified party as a result of the act or omission of the indemnifying party.

7.2 Guarantees

The use of guarantees in construction contracts is common in Malaysia to limit risk for the employer. The common types of bank guarantees in construction contracts are:

- advance payment guarantee to secure the repayment of the advance payment – the bank guarantee is usually in the amount of the advance payment;
- performance guarantee to secure the proper performance of the contractor's obligations –

the bank guarantee is usually in the amount of a percentage of the contract price;

- DLP/warranty guarantee to secure the contractor's performance of its obligations during the DLP – the bank guarantee is usually in the amount of a percentage of the contract price; and
- parent company/corporate guarantee provided by the contractor's parent company to secure the proper performance of the contractor's obligations.

The bank guarantees usually must be unconditional and on-demand guarantees issued by a financial institution approved by the employer. The contractor is normally obliged to renew the bank guarantees if the initial expiry date is earlier than the period in which such bank guarantees must remain valid under the contract. The contract may also provide for circumstances under which the employer may make a demand under the bank guarantees.

7.3 Insurance

Normally under the construction contract, the contractor will need to take out and maintain insurances throughout the contract period, including:

- insurance to cover liability of the contractor and subcontractor for personal injuries, death, or damage to property arising from the execution of the works, such as contractor's/construction all-risks, workmen's compensation, public liability, and motor vehicle insurance;
- insurance to cover the executed works, materials and goods on site against loss and damage; and
- professional indemnity insurance to cover design works and/or professional services if such scope is provided by the contractor.

The contractor is normally required to include the employer as an insured and to provide proof of the insurances. The employer may have a right to take out any insurance that the contractor fails to take out and to back-charge the premiums to the contractor by either setting off against the payments due under the contract or having recourse against the bank guarantees.

Some contracts may provide for specific insurances to be taken out by the employer.

7.4 Insolvency

Most construction contracts will provide allow a party to terminate the contract in the event of insolvency of the other party. Such right is typically available for both the employer and the contractor. If the contractor consists of a consortium of companies, parties may agree that the insolvency of a consortium member will not automatically trigger the employer's right to terminate if the other consortium members can prove their ability to complete the outstanding works.

The consequences of termination due to insolvency will typically be similar to the consequences of termination for breach by the employer or the contractor. See **9.6 Termination**.

7.5 Risk Sharing

Risk sharing is not a common practice in Malaysia because one main component of a construction contract is risk allocation. Parties usually prefer to have clear allocation of risks in the contract to avoid any dispute as to the responsible party for certain risks.

Most risks relating to the construction will be placed on the contractor, given that it is the party executing the works on site. The employer may agree to take up certain risks owing to commer-

cial considerations (eg, to lower the contract price).

The allocation of risks also depends on the nature of the project.

- In a build-only project, the risk of design defects lies with the employer, as the employer or its consultant will undertake the design.
- In a design-and-build project, the risk of design defects normally lies with the contractor, which is the designer.

Notwithstanding the foregoing, it is still up to the parties to negotiate the sharing of certain risks. Instances of risk sharing in construction contracts are as follows.

- Fluctuation of material costs – the parties can agree to a mechanism of adjustment of contract price in the event the increment in costs is more than a percentage. This means that the contractor will take the risk of material costs increment up to the prescribed percentage and any further increment will be at the employer's risk.
- Force majeure – typical risk sharing in the event of force majeure is that the delay will be at the employer's risk (ie, the contractor will be entitled to EOT), whereas any prolongation costs will be at the contractor's risk (ie, the contractor will not be entitled to any additional costs).

8. Contract Administration and Claims

8.1 Personnel

Generally, parties to the construction contract are responsible for the acts or omissions of their own personnel. The contractor is usually

required to warrant that it will provide sufficient and skilled personnel to perform all its obligations under the contract.

Parties may be required to appoint their representatives. Such representatives will have all the rights and obligations provided under the contract, such as the giving and receiving of any notice, instructions and documents. The acts of a party's representative are normally binding on such party. Where there is a contract administrator, such contract administrator will usually assume the role as the employer's representative vis-à-vis the exercise of the employer's powers under the contract. At the same time, the contract administrator is required to act independently and neutrally in assessing applications and issuing certificates under the contract.

Some contracts may contain provisions dealing specifically with the contractor's "key personnel" (ie, personnel who play an important role in ensuring the due execution of the works). It is not uncommon for the construction contract to provide that the key personnel cannot be removed or replaced without the consent from the employer.

8.2 Subcontracting

Most construction contracts will allow for the subcontracting of part of the works subject to the consent of the employer. Sometimes there may be express prohibition on subcontracting a substantial portion of or the entire works.

Some contracts contain provisions specifically on nominated subcontractors (ie, the subcontractors nominated and approved by the employer). The contract may provide that the contractor does not need to obtain the employer's prior consent for the subcontracting of works to the nominated subcontractor or that certain works

can only be subcontracted to the nominated subcontractor and not any other persons. The contractor may be given rights to raise objections to the subcontractors nominated by the employer.

Construction contracts will typically provide that the contractor is responsible and liable for the acts and omissions of the subcontractors and shall not be relieved from any of its obligations under the contract, regardless of any approval or nomination by the employer.

8.3 Intellectual Property

The IP provisions differ from one contract to another. Normally any IP provided by the employer and IP created in the project will belong to the employer. The contractor usually remains the owner of its IP used in the project but is required to grant a licence to the employer for the use of such IP without charging separate licensing fees or royalties.

The typical IP provisions in construction contracts may also deal with any infringement of IP of a third party and will normally require the contractor to indemnify the employer against any infringement claims by a third party.

9. Remedies and Damages

9.1 Remedies

In the event of a breach of the construction contract, apart from the employer and the contractor, other third parties will have no claim for the breach as they are not party to the contract.

Remedies for Employer

If the contractor breaches the construction contract, it will typically give the employer a right to terminate the contract by providing a notice.

The employer may be required to allow the contractor a period in which to remedy the breach before it can exercise the termination right.

The employer may also exercise the contractual remedies specific to certain breaches – for example, liquidated damages for delay in the achievement of completion or a milestone. The contract may also provide the employer rights to other remedies such as withholding payment, setting off against payment, and demand on bank guarantees.

Apart from the contractual remedies provided, the employer will have a right at common law to claim for damages suffered due to the contractor's breach. If the breach is a fundamental breach that goes to the root of the contract, the employer may choose to terminate the contract at common law.

Remedies for Contractor

If the employer breaches the construction contract, it will typically give the contractor a right to terminate the contract by providing a notice. The contractor may be required to allow the employer a period in which to remedy the breach before it can exercise the termination right.

The contractor may also exercise contractual remedies that are specific to certain breaches, such as late payment interest. The contract may also provide the contractor rights to other remedies such as suspension of works.

Apart from the contractual remedies provided, the contractor will have a right at common law to claim for damages suffered due to the employer's breach. If the breach is a fundamental breach that goes to the root of the contract, the contractor may choose to terminate the contract at common law.

9.2 Restricting Remedies

It is common for the construction contract to provide certain limits or restrictions on the remedies available to a party. See **6.1 Exclusion of Liability** and **6.3 Limitation of Liability**.

9.3 Sole Remedy Clauses

Some construction contracts may provide that certain remedies are the sole and exclusive remedies for specific breaches. As long as such clauses are clearly and unambiguously drafted, they will usually be upheld and enforced by the court or the arbitral tribunal. See **6.1 Exclusion of Liability** and **6.3 Limitation of Liability**.

9.4 Excluded Damages

It is common for parties to exclude the liability for indirect and consequential losses arising from or in connection with the construction contract, such as loss of profits, loss of goodwill, and loss of business. See **6.1 Exclusion of Liability** and **6.3 Limitation of Liability**.

9.5 Retention and Suspension Rights

Retention of Title

Generally, the construction contract provides for the timing whereby the title to the goods and materials is transferred, and such clause will normally be enforceable. Depending on the nature of the projects, the parties can agree that:

- title to the goods and materials remains with the contractor until such goods and materials have been paid for/are incorporated into the works; and
- title to the goods and materials passes to the employer upon delivery to the site.

Normally the risks to the goods and materials will pass together with the title but parties are free to agree on separate provisions on the passing of such risks.

Suspension of Works

Unless expressly provided under the construction contract, there is generally no right for the contractor to suspend works, regardless of the reasons for such suspension. Suspension without right will be a breach of the contract.

Some contracts may provide rights of suspension in the following circumstances:

- the contractor may suspend works in the event of non-payment by the employer of any certified/undisputed sum; and
- the employer/contract administrator may have rights to instruct the contractor to suspend any part of the works.

Under Section 29 of the CIPAA, if the contractor obtains a favourable adjudication decision, it may suspend or reduce the progress of the works until such adjudicated sum is paid by the employer.

9.6 Termination

Generally, the construction contract will set out events of default that allow a party to terminate the contract. Alternatively, if a party commits a fundamental breach of the contract, a termination right may arise at common law.

Some contracts may allow the employer to terminate the contract for convenience.

In public projects involving the government/government-linked companies, there may be provisions for termination on national interest or corruption – see the JKR standard form contracts.

Consequences of Termination

Consequences of termination are typically provided under the contract and normally include the following:

- parties are relieved from any rights and obligations, apart from those accrued before the termination date and those intended by the parties to survive the termination;
- payment for the works properly executed up to the termination date;
- the contractor ceasing all operations, removing all materials, equipment and goods belonging to the contractor from the site and vacating the site; and
- liability for any loss/damage suffered by the non-defaulting party due to the termination.

10. Dispute Resolution

10.1 Regular Dispute Resolution

Parties to construction contracts are free to agree to their preferred dispute resolution avenue, which is usually arbitration or court.

Arbitration

Most construction contracts in Malaysia provide for any dispute to be resolved through arbitration. The arbitrations in Malaysia are governed by the Arbitration Act 2005.

Typically, construction contracts in Malaysia will provide for arbitration administered by the AIAC. However, parties are free to agree to the institution administering the arbitration, the rules to be adopted for the arbitration, as well as the seat, language and governing law of the arbitration, and the number of arbitrator(s).

Court

Without an arbitration agreement, disputes under construction contracts will be resolved through the courts of Malaysia. Some contracts expressly provide for parties' submission to the jurisdiction of the courts of Malaysia. The High Courts in Kuala Lumpur and Shah Alam, Selangor have specialised Construction Courts that deal with construction matters.

10.2 Alternative Dispute Resolution

Statutory Adjudication

Apart from the above, there is an additional avenue for statutory adjudication under the CIPAA. The CIPAA came into force on 15 April 2014 to provide speedy resolution of payment disputes under construction contracts.

The whole adjudication process is primarily based on documents only and usually takes around three to four months for the adjudication decision to be rendered. The decision is binding on the parties until such dispute is finally resolved in arbitration or court.

Mediation

Mediation is encouraged but is not mandatory. It is uncommon for parties to a construction contract to resolve disputes through mediation, unless it has been pre-agreed in the contract or directed by the court. The Mediation Act 2012 governs the conduct of mediations in Malaysia.

Trends and Developments

Contributed by:

Lim Siaw Wan and Chris Tan
Christopher & Lee Ong

Christopher & Lee Ong (CLO) is a member firm of Rajah & Tann Asia, one of the largest full-service Association of South-East Asian Nations legal networks, with access to a network of law firms across South-East Asia with more than 1,000 fee earners, including in Cambodia, China, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam. CLO's construction and projects practice group is one of the leading practices in Malaysia, housing a team of lawyers with extensive experience in a wide range of projects, including energy and resources, infrastructure, water, oil and gas instal-

lations, airports, highways and toll roads, ports, tunnels, rail systems, sewerage systems, mines and mineral processing facilities. CLO is well-versed with the numerous agreements involved in projects such as concession agreements, power purchase agreements (PPA), construction agreements, design and build contracts, engineering, procurement and construction contracts, operation and maintenance agreements, engineering and consultancy agreements, service agreements, and the standard forms of contract adopted in Malaysia.

Authors



Lim Siaw Wan is a partner in Christopher & Lee Ong's projects and infrastructure practice group, specialising in front-end construction and project development work. She

has worked in the projects space for more than 15 years and has amassed considerable experience in areas such as data centres, power projects, renewable energy projects and infrastructure (including rail, roads/highways, and telecommunications). Siaw Wan is recognised and listed in established legal directories as a leading individual in project development covering multiple industries, including construction and materials, energy, oil and gas, and transportation. She is a member of the Bar Council of Malaysia and the Kuala Lumpur Bar and the Honourable Society of Lincoln's Inn.



Chris Tan is a senior associate in Christopher & Lee Ong's projects and infrastructure practice group. Chris focuses on various matters relating to energy (conventional and

renewable), projects and infrastructure, and construction and property development. He also regularly advises on issues relating to project documents and management, including issues relating to extension of time, delay and performance liquidated damages, bank guarantees, environmental law and occupational health issues. Chris' experience further extends to arbitration, adjudication, and court litigation, and he has appeared at all levels of courts in Malaysia. Chris is a member of the Bar Council of Malaysia, the Kuala Lumpur Bar and the Honourable Society of Middle Temple.

Christopher & Lee Ong

Level 22 Axiata Tower
No 9 Jalan Stesen Sentral 5
Kuala Lumpur Sentral
50470 Kuala Lumpur
Malaysia

Tel: +603 2273 1919
Fax: +603 2273 8310
Email: clo-info@christopherleeong.com
Web: www.christopherleeong.com

CHRISTOPHER & LEE ONG

Introduction

This article discusses the key policies and initiatives in Malaysia to integrate the ESG frameworks into the construction industry. It further examines the use of smart contracts and standard form contracts in the construction industry in Malaysia.

ESG in Malaysia's Construction Industry

ESG continues to be one of the most-used catchwords by corporations. But what exactly is ESG? ESG is a multifaceted framework that evaluates the sustainability and ethical impact of companies and is closely related to the construction industry.

In terms of the environmental aspect, ESG emphasises environmentally responsible practices in construction through the efficient use of resources and waste reduction, carbon emissions reduction, and the use of green technologies.

As regards the social aspect, ESG is concerned with the occupational health and safety practices within the construction industry. It also involves evaluating the social consequences of construction projects by carrying out social impact assessments.

In respect of the governance aspect, ESG promotes ethical and transparent governance by ensuring responsible decision-making and compliance, including the introduction of ESG reporting and sustainable accounting practices.

How is the construction industry in Malaysia adopting ESG?

In Malaysia, the ESG framework plays a crucial role in shaping the construction industry now and in the future.

Malaysia has introduced some key policies and initiatives to actively align with global ESG standards, as follows.

- The National Construction Policy 2030 (NCP) is a strategic framework aimed at transforming Malaysia's construction sector towards the digital era and envisions a developed and sustainable Malaysia with inclusive economic distribution. The NCP prioritises sustainable construction practices, including the use of green design and technology. It encourages R&D efforts to enhance sustainability, particularly in areas such as low emissions and climate resilience. The NCP aims to drive Malaysia's construction industry towards international recognition, sustainability and

competitiveness by leveraging digitalisation and inclusive practices.

- By-Law 38A of the Uniform Building (Amendment) By-Laws 2021 (“By-Law 38A”) under the Street, Drainage and Building Act 1974 was first introduced in 2012 and amended in 2021. By-Law 38A mandates energy efficiency requirements for new or renovated non-residential buildings with air-conditioned spaces exceeding 4,000 square metres. Such buildings must be designed to meet the requirements of MS 1525 with regards to the Overall Thermal Transfer Value (OTTV) and the Roof Thermal Transfer Value (RTTV) and shall be provided with an energy management system. Further, By-Law 38A provides for certain limitation on the thermal transmittance (U-value) of the roof for all buildings (residential and non-residential) in Malaysia.
- The Malaysian Carbon Reduction and Environmental Sustainability Tool (“MyCREST”) empowers Malaysia’s construction industry to embrace sustainability, reduce environmental impact, and create resilient built environments. MyCREST aims to guide, assist, quantify and reduce the environmental impact of built environments by considering a holistic life cycle perspective, focusing on carbon emissions reduction and overall sustainability. MyCREST is endorsed by the Ministry of Works and the Construction Industry Development Board.
- The green taxes, including the Green Investment Tax Allowance (GITA), provide tax relief for investments in green technologies and sustainable practices. The Green Income Tax Exemption (GITE) provides income tax exemptions to entities engaged in environmentally friendly initiatives. These incentives drive the adoption of sustainable practices, such as energy-efficient designs and eco-friendly materials.

- The amendments to the Occupational Safety and Health Act 1994, which have come into effect on 1 June 2024, impose more stringent duties on employers (and significantly increased penalties and punishments for any breach) vis-à-vis the occupational safety and health of workers, including those in the construction industry. In addition, the Minister of Human Resources has further made the Occupational Safety and Health (Construction Work) (Design and Management) Regulations 2024 which introduce some significant duties relating to safety and health on the parties involved in construction projects, including the clients, the contractors as well as the designers, to make the construction sites a safer workplace for all persons involved.

Challenges and the future of ESG

Despite the initiatives relating to the Malaysian construction industry’s adoption of the ESG framework and standards, there are still various challenges in harmonising the local practices with the global ESG standards. These challenges include the perception that compliance with the global ESG standards will result in higher project costs. As most of the ESG initiatives are not legally mandatory, the level of adoption varies across the country. It is thus important to educate all stakeholders about the long-term benefits and returns of sustainable practices.

The future of ESG lies in holistic integration within Malaysia’s construction industry. It is hoped that companies will increasingly embed sustainability principles into every stage of project development, from design to operation. Such integration will also involve the use of digital tools and smart technologies to enhance transparency, data accuracy and overall sustainability, which will in turn drive the industry towards ESG compliance.

Smart Contracts – Do They Live Up to Their Name?

Use of technology in construction projects

As construction demand continues to grow, there has been increasing use of technology in the construction industry. Companies now try to figure out when and how they will adapt to these technological advancements in order to stay ahead of their competitors, be more cost efficient and improve occupational health and safety of the workers.

Technologies used in the construction industry include virtual and augmented reality, AI, AI-powered drones, blockchain technology, digital twins, and building information modelling.

What is blockchain and how does it relate to smart contracts?

“Blockchain” is a term that has been trending in recent years, and the scope and use of blockchain technology have been expanding over time and are no longer limited to industries such as cryptocurrency.

To put it very simply, blockchain technology is a distributed database or ledger shared among a computer network’s nodes, which allows for transparency in information sharing because of its decentralised and immutable nature. Data is stored in blocks that are linked together in a chain that cannot be deleted or modified without consensus from the network. Therefore, blockchain technology can be used as an unalterable or immutable ledger for tracking orders, payments, accounts, and other transactions.

One of the uses of blockchain technology is the invention of “smart contracts”. Smart contracts were introduced in the 1990s and consist of an automated mechanism stored on a blockchain that can automatically execute or perform cer-

tain obligations when the predetermined conditions are met. It serves as linked collections of data “blocks” that make up a digital ledger, with the records of all transactions and completed milestones.

Smart contracts differ substantially from the traditional contracts, which are required to be signed by the parties and performed in accordance with written terms that may be open to different interpretations by different parties.

Advantages of using smart contracts in construction projects

Smart contracts are created to eliminate any ambiguity in the performance of contractual obligations because they work on an “if/then” basis recorded via coding – ie, if the conditions/criteria set out are met, then the smart contract will self-execute the consequential step without the need of any action by any party.

By way of example, in the context of a construction project, smart contracts can be used in the following circumstances.

- Smart contracts can monitor payments and speed up the cashflow, which may in turn accelerate the progress of the project. Once the criteria of a construction process/milestone are met, payment will be made automatically. This would eliminate the traditional procedures of submitting and reviewing payment claims, which may involve a great deal of paperwork and time before the contractor gets paid.
- Smart contracts can increase productivity and streamline the process, especially if many parties and subcontractors are involved in the project. Transition between the main contractor and multiple subcontractors can cause miscommunication and mistakes that

delay the project and/or produce a product that differs from what the employer wants. With the use of a smart contract, all parties including the subcontractors can access all relevant documentation (including the original drawings and plans, and any changes thereafter) and prevent any loss of documents and data during transfer of such from one party to another. The employer will also be apprised of any issues of delay in the progress and the responsible party.

- Smart contracts can save project costs. The use of smart contracts can potentially reduce the transaction and operating costs while minimising human errors, as they remove the need for intermediaries in dealing with the paperwork required under the traditional contracts.
- Smart contracts promote transparency in project management. Smart contracts are automated, decentralised and immutable. The data entered into a blockchain cannot be altered, and no single party has the full control of the blockchain.

Obstacles in adopting smart contracts in construction projects

Although the use of smart contracts may be advantageous for all parties, it is in fact not entirely foolproof. There are various practical and legal challenges inherent in adopting smart contracts in a construction project and, consequently, employers have been slow to adopt such a technology – even though it can potentially bring the above-mentioned advantages in terms of project management.

These challenges include the following.

- The legality and enforceability of smart contracts are still in question (as will be discussed later in this article). Although smart

contracts are nominally contracts, the issue of whether they are legally binding contracts remains a topic of debate, as their formation and mode of execution are in no way close to those of conventional contracts.

- Human involvement and intervention are required. The coding of smart contracts is a human process and, as such, is vulnerable to human errors. Intervention and oversight are still required to ensure that the terms agreed to by the parties are properly coded into smart contracts and will run exactly as programmed.
- There may not be savings in costs. Adopting smart contracts requires parties to have the technical knowledge and expertise in coding to produce the envisaged automated mechanism of smart contracts. Given that blockchain technology is niche and highly technical, the savings in utilising smart contracts may not be commensurate with the costs of hiring personnel with the relevant expertise and developing the mechanism.
- Highly complex/subjective terms may be difficult to capture in smart contracts. Construction contracts often involve highly complex processes such as assessment of claims by the employer or involve clauses featuring subjective standards such as “material breach”, “reasonable time” and “determined by the employer”. It is difficult to capture terms of this nature on an “if/then” basis in smart contracts, unless the parties agree upfront on certain objective standards triggering the relevant provisions, which is most likely infeasible in real life.
- Smart contracts are immutable. A prominent feature of smart contracts is the immutability of the codes and data entered into the blockchain, which cannot be altered and will execute automatically upon the satisfaction of the relevant conditions. This may pose dif-

difficulties if the parties wish to revise the terms or to reverse any transactions made.

- Smart contracts are vulnerable to cyber-attacks. As with everything stored virtually, smart contracts are open to cyberattacks by hackers, or could suffer damage due to defective coding or system glitches. The parties may have to invest in cybersecurity if they are adopting smart contracts.

Status in Malaysia – are smart contracts really contracts?

Even though smart contracts are gaining recognition globally, as far as the laws in Malaysia are concerned, a question mark remains over the legality and enforceability of smart contracts – as mentioned earlier.

Contracts in Malaysia are governed primarily by the Contracts Act 1950, as well as case law established by the courts. A contract is legally binding only if the elements of a “contract” have been satisfied (ie, offer, acceptance, consideration, and intention to create legal relations). Without those elements, smart contracts are in fact more akin to coded computer software facilitating the execution of a construction project, rather than being capable of binding the parties.

Adjustments to Malaysian laws may be required for smart contracts to be enforceable in Malaysia – be it through enactment of new legislation, amendments to the existing legislation, or the court’s interpretation of the existing legislation in the context of smart contracts. Without clear legal recognition of smart contracts in Malaysia, it is likely that parties in construction projects will be careful and slow in adopting smart contracts, notwithstanding the benefits they may bring.

What does the future hold for smart contracts?

As things stand, smart contracts are unlikely to fully replace traditional construction contracts in the near future, owing to the challenges outlined here. While the technology may appear promising, there are associated legal and practical challenges that need to be addressed.

However, companies should not overlook the benefits of adopting smart contracts in construction projects. It is no secret that the construction industry is often burdened by issues of late payments and delays. Smart contracts can be a powerful tool in terms of project management of progress and payments, to be used in executing contractual obligations under traditional contracts.

In the future, it is possible that technology will advance to a stage where smart contracts are able to handle complex transactions. When the time comes, assuming that the legal framework for smart contracts is in place and properly developed, smart contracts definitely have the potential to reduce or even replace the need for traditional construction contracts.

Standard Form Contracts – Yea or Nay?

The latest standard form contracts in Malaysia were launched in January 2024 by the Asian International Arbitration Centre (AIAC), namely:

- AIAC Standard Form of Building Contract 2024, replacing the previous 2019 edition; and
- AIAC Islamic Standard Form of Building Contract 2024, which is a new standard form building contract in compliance with Sharia principles.

Various versions of existing standard form construction contracts have been introduced in recent years. The use of standard form contracts is rather common in the construction industry in Malaysia. The employer usually chooses which standard form contract to adopt and the choice largely depends on the familiarity of the employer with the terms of such contract. That said, it is not uncommon to see the use of bespoke contracts in bigger or more complex projects.

What are standard form contracts?

Standard form contracts are made up of standardised and pre-written terms that parties can use for the type of transaction contemplated in the contract. They are usually designed to save time, resources and legal costs by having a consistent framework of common contractual terms relating to the parties' rights and obligations. These standard form contracts are normally customisable to a certain extent, in order to reflect parties' intentions correctly and accurately.

As time is of essence in all construction projects, construction contracts are quite often the matter that parties are reluctant to spend much time on – even though the contracts form the basis of the parties' rights and obligations in the project – because the drafting and negotiation of construction contracts can be protracted and time-consuming. The construction industry has thus developed various standard form contracts, which can be adopted by parties relatively quickly by limiting the commercial decisions to be made by the parties (eg, the contract price, the scheduled completion and milestones dates, the liquidated damages rates, and the scope of works).

Types of standard form construction contracts in Malaysia

The following types of standard form construction contracts are commonly used in Malaysia.

- PAM contracts – the standard form construction contracts published by the Malaysian Institute of Architects (*Pertubuhan Arkitek Malaysia*, or PAM) are build-only contracts under which the architect acts as the contract administrator. In 2018, PAM launched a newer version of its standard form contract (with and without quantities) and subcontract, replacing the versions published in 2006.
- The FIDIC suite of contracts – the International Federation of Consulting Engineers (*Fédération Internationale des Ingénieurs-Conseils*, or FIDIC) suite of contracts comprises, among others, the Red Book (Construction Contract), the Silver Book (EPC/Turnkey Contract) and the Yellow Book (Plant and Design-Build Contract). International employers and/or contractors may prefer to use the FIDIC suite of contracts in their projects in Malaysia owing to their familiarity with FIDIC contracts' terms, under which the contracts are administered by engineers. FIDIC updated its suite of contracts in 2017, replacing the versions launched in 1999.
- PWD standard form contracts – standard form contracts published by the Public Works Department of Malaysia (PWD) are commonly used in government-related projects in Malaysia. The contract administrator under the PWD contracts is the superintending officer.

Other types of standard form contracts used in projects in Malaysia (albeit less frequently than the above-mentioned standard form contracts) include:

- standard form contracts for building works published by the Construction Industry Development Board of Malaysia (CIDB) – the CIDB launched a new edition of the contract in 2022, replacing the first edition published in 2000;
- standard form contracts for engineering works published by the Institute of Engineers Malaysia (IEM); and
- standard form contracts for building works/design and build works published by the AIAC.

Pros and cons of using standard form construction contracts

The advantages of using standard form construction contracts are as follows.

- Industry acceptance – standard form construction contracts are quite often immediately acceptable to experienced companies within the construction industry, with limited negotiations (especially if both parties involved are familiar with said standard form contract).
- Savings in time and costs – thanks to industry acceptance of standard form contracts, the conclusion of the construction contract for a project can be expedited, saving the time and resources of both parties. Further, more often than not, standard form construction contracts are used without (or with limited) engagement with lawyers, which in turn translates to savings in terms of legal costs and resources.
- Consistency and balanced risk allocation – standard form construction contracts are normally drafted to be used across multiple projects while ensuring uniformity in applicable contractual terms and provisions, which may facilitate project management. Further, standard form contracts usually have more

balanced risk allocation between the parties, taking into account the common risk factors in the type of construction project.

However, the use of standard form construction contracts is not always sunshine and rainbows. The want for expedience and cost cutting may come with pitfalls, as standard form contracts cannot possibly cover the circumstances and parties' intentions in the same way as a bespoke, negotiated contract. The following are among the common pitfalls of standard form construction contracts.

- Suitability – sometimes, parties adopt a standard form contract without properly considering the nature of the relevant construction project. The one-size-fits-all approach may not be able to cover all peculiarities of a project and there may be a lack of contractual provisions dealing with certain issues when they arise.
- Bankability – given the balanced risk allocation of most standard form construction contracts, lenders may be reluctant to accept standard form construction contracts as sufficient security for the funding of the project.
- Amendments or modifications to standard form contracts – it is common for parties to amend or modify certain terms of the standard form construction contract (eg, by way of particular conditions in the FIDIC suite of contracts). Given the usual lack of involvement of lawyers in the use of standard form contracts, there may be issues concerning the consistency of the amended terms with the rest of the contract, which may result in conflicting provisions that need to be resolved before works can continue.
- Familiarity – the use of standard form construction contracts may give rise to an unfair advantage to a party when the other party is

unfamiliar with the standard form to be used. Issues often arise when the unfamiliar party realises that it has not strictly complied with certain mandatory requirements under the standard form contract when making claims, such as for variation and extension of time.

Should standard form contracts be used in construction projects in Malaysia?

The answer ultimately varies based on circumstances. The best practice depends on the nature and size of the project and the awareness of the parties involved.

As with all contracts, whether bespoke or standard form, it is crucial for parties to be aware of all the rights and obligations contained under the contracts being entered into. The parties need to ensure that the contract reflects their intentions vis-à-vis the completion of the construction project. If the parties are fully aware and well-informed of the content of the standard form contract they are entering into, and as long

as the parties are careful in filling in the forms and choosing the optional clauses (if any), there is nothing wrong with using it to save money and time and to proceed immediately to the actual construction works.

For bigger and more complex projects in Malaysia, it is not uncommon to see parties adopting a mid-point between standard form contracts and fully bespoke contracts by creating a contract using a standard form contract as a base to suit the needs of the parties.

All in all, notwithstanding the flaws in standard form construction contracts, their widespread use and industry recognition cannot be denied. The use of standard form construction contracts is an efficient way to conclude a contract, with terms and conditions that are functional and generally standard for most construction projects. They are here to stay and will likely continue to be updated by the relevant industry players from time to time.

NETHERLANDS



Law and Practice

Contributed by:

Peter Habraken, Sjoerd Rutten and Anna Kapteijn
HabrakenRutten

Contents

1. General p.414

- 1.1 Governing Law p.414
- 1.2 Standard Contracts p.414

2. Parties p.415

- 2.1 The Employer p.415
- 2.2 The Contractor p.415
- 2.3 The Subcontractors p.415
- 2.4 The Financiers p.416
- 2.5 The Designer p.416

3. Works p.416

- 3.1 Scope p.416
- 3.2 Variations p.416
- 3.3 Design p.416
- 3.4 Construction p.416
- 3.5 Site p.416
- 3.6 Permits p.416
- 3.7 Maintenance p.417
- 3.8 Other Functions p.417
- 3.9 Tests p.417
- 3.10 Completion, Takeover and Delivery p.417
- 3.11 Defects and Defects Liability Period p.417

4. Price p.417

- 4.1 Contract Price p.417
- 4.2 Indexation p.418
- 4.3 Payment p.418
- 4.4 Invoicing p.418

5. Time p.418

- 5.1 Planning and Programme p.418
- 5.2 Delays p.418
- 5.3 Remedies in the Event of Delays p.418
- 5.4 Extension of Time p.418
- 5.5 Force Majeure p.419
- 5.6 Unforeseen Circumstances p.419
- 5.7 Disruption p.419

6. Liability p.419

- 6.1 Exclusion of Liability p.419
- 6.2 Wilful Misconduct and Gross Negligence p.419
- 6.3 Limitation of Liability p.419

7. Risk, Insurance and Securities p.419

- 7.1 Indemnities p.419
- 7.2 Guarantees p.420
- 7.3 Insurance p.420
- 7.4 Insolvency p.420
- 7.5 Risk Sharing p.420

8. Contract Administration and Claims p.420

- 8.1 Personnel p.420
- 8.2 Subcontracting p.420
- 8.3 Intellectual Property p.420

9. Remedies and Damages p.420

- 9.1 Remedies p.420
- 9.2 Restricting Remedies p.421
- 9.3 Sole Remedy Clauses p.421
- 9.4 Excluded Damages p.421
- 9.5 Retention and Suspension Rights p.421
- 9.6 Termination p.421

10. Dispute Resolution p.421

- 10.1 Regular Dispute Resolution p.421
- 10.2 Alternative Dispute Resolution p.421

HabrakenRutten is an industry sector boutique law firm focusing on all legal aspects of built and natural assets. The firm's expertise not only encompasses traditional buildings and infrastructure but also all linear and portable assets such as trains, ships, offshore rigs, networks and related technology. Widely recognised as a market leader, HabrakenRutten has been part of nearly every significant project in the Netherlands in the past ten years. The firm has unparalleled knowledge of best market practice and the distribution of risk in this sector. Habraken-

Rutten has six partners and 16 lawyers, all specialists in aspects surrounding infrastructure, real estate, energy and IT/tech, who represent clients not only with advice, drafting and negotiation but also in litigation and arbitration. The firm's recent track record includes renegotiating and litigating a D&C contract for Amare, in The Hague, and advising one of the largest Dutch tank terminal operators on the construction of a new mega tank terminal in the port of Rotterdam.

Authors



Peter Habraken is a partner at HabrakenRutten and a well-known legal adviser in large projects in the infrastructure, energy/industry, real estate and transport/logistics sectors. His

long-standing focus on asset development and involvement in nearly every significant PPP project in the Netherlands ensures that his clients have access to best market practice, as well as practical solutions to unique situations. Appreciated for his commercial approach, clients rely on him to achieve "bankable" legal structures and desired exit strategies, as well as risk management throughout the entire life cycle of a project. Peter is a co-founder and member of the Dutch and German Lawyers Association.



Sjoerd Rutten is widely recognised as being one of the leading advisers in contentious matters related to construction. Having maintained a particular focus on construction, project

development, public procurement and PPP throughout his career, he is the go-to adviser for contractors, architects, engineers, project developers, sponsors and authorities seeking advice and representation in litigation and arbitration, as well as on dispute prevention. In addition to being a partner at HabrakenRutten, Sjoerd is a member of the editing board of the Magazine for Construction Law and regularly contributes articles to other leading journals. He is also the author of several books on topics within his expertise.

Contributed by: Peter Habraken, Sjoerd Rutten and Anna Kapteijn, **HabrakenRutten**



Anna Kapteijn is a real estate lawyer and counsel at HabrakenRutten with a decade of experience in construction and project development, renewable energy, project financing and procurement law. Since 2016 she has combined her legal practice with doctoral research at the University of

Amsterdam, focusing on allocation of risk and co-operation between parties in integrated construction contracts. Anna also teaches master's courses in procurement law, contract law and construction law. She previously worked as a lawyer in the projects and real estate team at Allen & Overy and in the construction law team at Stibbe.

HabrakenRutten

Weena 690
3012 CN Rotterdam
Netherlands

Tel: +31 88 374 4900
Fax: +31 10 412 7941
Email: s.rutten@habrakenrutten.com
Web: www.habrakenrutten.com

HABRAKEN r u t t e n

1. General

1.1 Governing Law

The main source of private law governing the construction market in the Netherlands is the Dutch Civil Code, or DCC (*Burgerlijk Wetboek*), in particular Books 3, 5, 6 and 7. Specifically, Title 12 of Book 7 DCC contains statutory provisions regarding construction (*aanneming van werk*). Title 12 of Book 7 DCC was amended by the Quality Assurance Construction Act (*Wet kwaliteitsborging voor het bouwen*) on 1 January 2024. These can be found at the website [here](#).

Public laws which govern the construction market are:

- the Environmental Permitting General Provision (*Wet algemene bepalingen omgevingsrecht*) and;
- the Environment Act (*Omgevingswet*).

The Procurement Statute (*Aanbestedingswet*) regulates procurement proceedings.

1.2 Standard Contracts

Generally, four sets of standard conditions are used for contracts relating to construction works – namely:

- UAV 2012, for a traditional construction contract;
- UAV-GC 2005, for a design-and-build contract (with the additional option of maintenance);
- DNR 2011, for a design/consultancy contract; and
- FIDIC, whose contracts cover most building organisation methods.

In traditional contracts, the responsibility for the design rests with the employer and the respon-

sibility for the execution of the construction process rests with the contractor. In integrated contracts (*geïntegreerde contracten*) the design responsibility is also part of the contractor's responsibility, and its extent depends on the contract. The most common contractual conditions are discussed below.

UAV 2012

These conditions are commonly used for an employer-contractor contractual relationship. They are typically used in traditional construction contracts, in which the employer is responsible for the design and specifications of the works, and the contractor is responsible for the execution of the works in conformity with the specifications.

The text of the UAV 2012 was agreed upon by representatives of employers and contractors jointly; the UAV 2012's conditions were therefore drafted with equal representation (*paritaire voorwaarden*).

UAV-GC 2005

These conditions are commonly used for an employer-contractor contractual relationship in a design-and-build project. They are used in integrated contracts. The degree to which the contractor is responsible for the design of the works can vary from partly to almost fully, and is optional for the parties.

The text of the UAV-GC was also drafted by representatives of employers and contractors jointly.

DNR 2011

These conditions are commonly used in contractor-designer/consultant or employer-designer/consultant contractual relationships. Most architects, engineers and consultants in the Nether-

lands work within the DNR 2011's conditions. These conditions govern the responsibility and liability of designers/consultants.

FIDIC

These conditions are commonly used in an employer-contractor contractual relationship. There are different types of FIDIC contracts, and the choice of specific contract will depend on the scope of the work and the risk allocation in the project:

- the FIDIC Red Book can be used in works in which the employer carries out the design and the contractor carries out the works;
- the FIDIC Yellow Book can be used where the contractor designs and executes the works; and
- the FIDIC silver book can be used for so-called turnkey contracts.

In the Netherlands, the use of these standard contracts is very common, and is mandatory for public authorities, with the UAV 2012 and UAV-GC 2005 having been jointly drafted by representatives of employers and contractors (*partijaire voorwaarden*).

2. Parties

2.1 The Employer

In construction projects, the employer is typically either a public authority or a private company. The general rights and obligations of the employer in construction contracts depend strongly on the contract between the parties. In traditional contracts (under the UAV 2012's conditions), the employer is responsible for the design, the permits and the soil. In general, the employer arranges the financing of the project. Alternatively, the contractor is sometimes tasked

with arranging the financing of the project (see **2.2 The Contractor**).

2.2 The Contractor

The contractor is responsible for the construction of the works. In integrated contracts, the contractor is also responsible for the construction and for (part of) the design. The contractor can also be responsible for the maintenance of the works after delivery. In some cases, the contractor may be tasked with arranging finance for the project – in this case, general project finance will be used, where the contractor attracts financing from lenders on a limited or non-recourse basis. Generally, the contractor corresponds with and co-ordinates the subcontractors. The contractor also corresponds with and reports to the employer.

In large construction projects in the Netherlands, the contractor is typically one of the large national private construction companies (Koninklijke BAM Groep, Volkerwessels, Koninklijke Boskalis, Strukton, TBI Holdings or Dura Vermeer) or international private companies (Denys, Fluor, Besix and Strabag). To distribute risks, these construction companies (or their subsidiaries) can form a consortium and create a special purpose vehicle (SPV) to carry out a project.

2.3 The Subcontractors

Contractors specialised in a particular discipline often act as subcontractors in construction projects. Normally, the general contractor is responsible for co-ordination between the subcontractors and their respective scopes of work. Obligations of the general contractor are generally passed on to the subcontractors on a “back-to-back” basis.

2.4 The Financiers

If external financing for construction projects is provided, this is typically done by national banks (such as ABN Amro, ING and Rabobank) or international banks. It is also possible for other lenders, such as pension funds, to act as financiers. In the event of project finance, the lenders perform due diligence on the project and on all contracts and permits regarding the project. A specific facility will be formed for the project on the basis of non-recourse or limited recourse financing.

2.5 The Designer

The responsibility for the execution of the design can be executed by the employer themselves, but will generally be placed by a designer. The previously mentioned DNR are generally used in this regard.

3. Works

3.1 Scope

The scope of work is generally laid out in a programme of requirements (*programma van eisen*). If the design has been completed by the employer and the scope of the construction contract is only the execution of the works, the scope of work is laid out in specifications (*bestek*), containing the technical requirements. These documents are generally an annex to the construction contract.

3.2 Variations

In general, both the employer and the contractor have the right to instigate variations in a request for change (*verzoek tot wijziging*, or *vtw*). The scope and price of the variations is subject to negotiation between the employer and the contractor, whereby the parties often agree before-

hand on unit rates that will be applicable in the event of variations.

3.3 Design

The contractor always bears responsibility for the construction of the works; alternatively, the contractor can also bear responsibility for the design. In traditional contracts, the employer is responsible for the design and the contractor is only responsible for the execution of the works (the execution often also includes detailed technical engineering). In integrated construction contracts, the contractor also bears responsibility to a varying extent for the design works.

3.4 Construction

In general, the contractor is responsible for the execution of the works. It is possible for the contractor to instruct subcontractors regarding parts of the works – in that case, the contractor remains responsible for the works of these subcontractors vis-à-vis the employer and generally also for the co-ordination of the subcontractors.

3.5 Site

In general, the employer is responsible for the site and access to the site. Responsibility for the soil and the soil conditions, including underground obstacles and pollution, is generally also borne by the contractor. It is possible, however, for the parties to agree otherwise in the contract.

3.6 Permits

For most activities regarding building, renovation, demolition, construction, the environment, nature and open spaces, an “all-in-one permit for physical aspects” (*omgevingsvergunning*) is required. This permit needs to be adhered to by all parties. The employer or the contractor can apply for this permit. In general, the employer is contractually responsible for the permit for the works. The contractor can be responsible for

the permit for aspects specifically regarding the actual execution of the works.

3.7 Maintenance

In general, the employer is responsible for maintaining the works after delivery. However, maintenance contracts for certain parts of the works can also be concluded between the parties involved in the construction process.

3.8 Other Functions

Besides the construction function, it is possible for the design function, the maintenance function, and the operation or finance function to be assigned to the contractor. It is also possible for only some of these functions to be assigned to the contractor.

3.9 Tests

As generally required in installation contracts, it is the contractor who usually bears responsibility for testing. Tests are carried out shortly before, and possibly after, completion.

3.10 Completion, Takeover and Delivery

In general, the contractor notifies the employer of the moment in time when the works will be completed and can be inspected for completion and delivery. If the employer then approves the works, delivery and taking over of the works takes place, and the risks associated with the work transfer from the contractor to the employer.

Normally, the employer cannot withhold approval of the works if there are only minor defects that do not prevent the employer from using the works and that can be remedied within a reasonable time. These minor defects will be put on a “punch list”. It is possible that after takeover the contractor will remain liable for (hidden) defects. An alternative process for delivery and/or for the

respective responsibilities may be laid down in the construction contract.

3.11 Defects and Defects Liability Period

The risks and responsibility for the works are generally transferred from the contractor to the employer after takeover. Minor defects after completion/takeover can be noted on the punch list and remedied by the contractor after delivery or takeover. Hidden defects that appear some time after takeover are generally to be remedied by the contractor, if the employer can prove that the contractor is liable for these defects. If parties agree on a defects liability period after completion, the contractor is responsible for remedying all defects, unless the contractor can prove that they are not liable for these defects. The scope of obligations of the contractor during the defects liability period can vary.

4. Price

4.1 Contract Price

The contract price is subject to negotiation between the parties or to a tender procedure. Usually, the contract price can be a lump sum; alternatively, the parties can agree on a unit rate contract, a reimbursable contract or a cost-plus contract.

The contract price generally entails:

- the direct costs for the execution of the works;
- site costs; and
- a surcharge for insurance, general costs, profit and risk.

Milestone payments are often used.

4.2 Indexation

In construction contracts, a regime for indexation is generally laid down. This applies to the contract price and possibly other amounts.

4.3 Payment

In general, the contractor invoices payments due to the employer. Payments may relate to milestone payments or lump-sum payments; the first are due after completion of the milestone, and the latter are generally payable after completion. In the event of late payment, the employer is usually under the obligation to pay interest to the contractor. Very late or structural late payment can constitute a default or breach of contract, allowing the contractor to suspend the works and ultimately to terminate the contract.

4.4 Invoicing

In general, the contractor sends invoices to the employer. These are usually payable after a period of approximately 30 days.

5. Time

5.1 Planning and Programme

Parties generally agree upon a commencement date and a long stop date for completion. Sometimes, milestone dates are applied by which part of the works must have progressed to a specific stage, generally with a corresponding milestone payment being due and often with a corresponding milestone certificate. Alternatively, the time for completion of the works can be expressed in a number of “workable working days”, calendar days, weeks or months.

In general, the contractor is free to make the planning/time schedule for the execution of the works, as long as this time schedule adheres to

the planning in the agreement. The time schedule is safeguarded by:

- monitoring the progress of the works;
- linking (interim) payments to progress achieved; and
- applying penalties in the event of late completion.

5.2 Delays

In the event of delays in the execution of the works, the parties can discuss and agree on the contractor taking acceleration measures. The costs of acceleration measures are usually borne by the party that is responsible for the delay. The law and the standard forms UAV 2012 and UAV-GC 2005 do not contain specific provisions on acceleration measures. A contractor that has caused delay can be forced in court to provide for a timely delivery of the works according to the contract. Generally, the contract contains penalties for the contractor for delays. These penalties are generally a fixed compensation for the delays.

5.3 Remedies in the Event of Delays

In the event of delays of the works caused by the contractor, the remedies available to the employer usually include:

- penalties;
- the postponement of interim payments; and
- if it becomes apparent that the contractor will not deliver the works in time, dissolving of the contract.

5.4 Extension of Time

The standard forms UAV 2012 and UAV-GC 2005 contain provisions regarding extensions of time for the contractor. The typical manner for the contractor to request an extension of time would be a written request to the employer, stating the

cause for the delay and invoking the applicable contractual right to an extension of time.

5.5 Force Majeure

Contracts generally contain a force majeure clause, stating that, in extraordinary events that are beyond the parties' control, the contractor and the employer are not bound by the contract and/or are not liable for damages. The most common events mentioned in these clauses include war, rebellion, riot and natural catastrophes. In the case of force majeure events, the contractor is usually entitled to an extension of time.

5.6 Unforeseen Circumstances

Unforeseen circumstances are regulated by mandatory law. If circumstances occur and the parties have not provided for the occurrence of these circumstances in the contract, the law provides for the possibility that the contract can be amended or dissolved by the court (Article 6:258 DCC). Also, the standard forms UAV 2012, UAV-GC 2005 and DNR 2011 contain clauses relating to unforeseen circumstances.

5.7 Disruption

Disruption not caused by the contractor can give the contractor grounds for extension of time and/or compensation. Standard forms UAV 2012, UAV-GC 2005 and DNR 2011 contain clauses that could provide the basis for a disruption claim. The burden to prove the cause of the disruption and its length lies with the contractor. The method for proving the cause/length of disruption varies from case to case; it typically involves comparing the predicted lead time with the actual lead time of a particular part of the works.

6. Liability

6.1 Exclusion of Liability

It is possible to exclude liability under Dutch law; however, the liability for wilful misconduct (*opzet*) and gross negligence (*bewuste roekeloosheid*) cannot be excluded. Furthermore, and as a general rule, an exclusion of liability cannot be invoked if under the given circumstances this would be unacceptable according to the standards of reasonableness and fairness.

6.2 Wilful Misconduct and Gross Negligence

Under Dutch law, the concepts of wilful misconduct and gross negligence exist. Liability for wilful misconduct (*opzet*) and gross negligence (*bewuste roekeloosheid*) cannot be contractually excluded under Dutch law.

6.3 Limitation of Liability

Dutch law allows the parties to contractually limit their liability. However, standard form UAV 2012 does not contain any limitations of liability, except for a limitation in time for hidden defects. Standard form UAV-GC 2005 contains a limitation of liability for hidden defects of 10% of the contract price. If limitations of liability are agreed upon in a construction contract, these limitations often exclude the liability for indirect or consequential damages, and limit the contractor's liability to a percentage of the contract sum.

7. Risk, Insurance and Securities

7.1 Indemnities

In the Netherlands, indemnities are generally used to limit risk, and it is common for one party to indemnify another against claims resulting from a breach of contract by the first party. If the employer is responsible for the design, it

is common for the employer to indemnify the contractor for claims arising from the design. It is also common for the employer to indemnify the contractor against claims resulting from the contractor's compliance with the employer's requirements. It is common for the contractor to indemnify the employer against claims resulting from the execution of the works or negligence.

7.2 Guarantees

It is common for the contractor to guarantee the performance of parts of the works or the complete works during a certain period of time. It is also common to agree on a defects liability period during which the contractor is obliged to remedy all defects in the works.

7.3 Insurance

The contractor is usually obliged to insure the works completely with a construction all-risk (CAR) insurance. Usually, the party responsible for the design also takes out a professional indemnity (PI) insurance for design errors/flaws.

7.4 Insolvency

The parties are generally entitled to terminate the contract in the event of insolvency of the other party.

7.5 Risk Sharing

Joint responsibility for certain risks can be set out in a construction contract. This is the case in partnering and alliancing contracts. These types of contracts are used, but in exceptional cases.

8. Contract Administration and Claims

8.1 Personnel

In general, the employer's and the contractor's personnel are described in the construction

contract. Key personnel on both sides (if any) are selected, and changes need to be informed about or consented to. Specific obligations and instructions can be assigned to the personnel.

8.2 Subcontracting

The right to subcontract can be regulated or limited in a construction contract. In general, subcontracting is permitted.

8.3 Intellectual Property

Intellectual property, patents, copyrights, trade marks and industrial properties are generally regulated in the sense that the parties determine which party holds these rights. It is possible for one party to indemnify another party against a third-party claim alleging infringement of one of these rights.

9. Remedies and Damages

9.1 Remedies

In the event of a default under the construction contract by the employer, the contractor is generally entitled to:

- claim performance of the contract;
- claim damages (alternative compensation);
- invoke on a right of suspension;
- invoke on a right of retention; and
- terminate the contract.

In the event of a default under the contract by the contractor, the employer is generally entitled to:

- claim performance of the contract;
- claim damages (alternative compensation);
- invoke on a right of suspension; and
- terminate the contract.

These rights and remedies can be altered in the contract. The party concerned is generally required to send a notice of default before claiming damages and/or terminating the contract.

9.2 Restricting Remedies

Retention rights are frequently limited in construction contracts. It is also possible to contractually limit suspension rights and the right to terminate the agreement.

9.3 Sole Remedy Clauses

Except for offshore and industry construction contracts, sole remedy clauses are not typically used in construction contracts.

9.4 Excluded Damages

The liability of parties and specifically the contractor is generally limited in construction contracts. According to the DCC, damages that are attributable to breach of contract are eligible for reimbursement. Sometimes, specific forms of damages such as indirect and consequential damages are excluded. These terms are not defined in the DCC. Indirect damages are generally contractually excluded.

9.5 Retention and Suspension Rights

Retention and suspension rights can be excluded. Sometimes, retention rights are excluded to the extent that the employer has not paid the undisputed invoices.

9.6 Termination

Typically, two types of termination of construction contracts are agreed on between parties:

- termination for cause (*ontbinding*); and
- termination for convenience (*opzegging*).

The DCC (*Burgerlijk Wetboek*) and the UAV 2012, UAV-GC 2005 and DNR 2011 contain articles that regulate these two types of termination.

In termination for cause, the contractor would normally be paid the price of the work that has been performed.

In termination for convenience, the contractor would normally, in accordance with the regulatory rules of the DCC, be compensated for the entire work and construction, reduced by the costs and expenses which the contractor has saved as a result of the termination. In practice, the sum to be paid by the employer would generally be the price of the part that has been realised, increased by any demobilisation costs, cancellation costs, and loss of unabsorbed overhead and profit.

10. Dispute Resolution

10.1 Regular Dispute Resolution

The district courts have jurisdiction in construction cases. The courts in the Netherlands have three tiers, as follows:

- 11 district courts;
- four appeal courts; and
- the Supreme Court.

10.2 Alternative Dispute Resolution

An important alternative means of dispute resolution is arbitration before the Netherlands Arbitration Institute (*Nederlands Arbitrage Instituut*) or the Board of Arbitration in Construction Disputes (*Raad van Arbitrage in Bouwgeschillen*). An agreement for arbitration is necessary. Furthermore, parties can agree on dispute resolution by means of binding or non-binding advice or mediation.

Trends and Developments

Contributed by:

Sjoerd Rutten and Peter Habraken

HabrakenRutten

HabrakenRutten is an industry sector boutique law firm focusing on all legal aspects of built and natural assets. The firm's expertise encompasses traditional buildings and infrastructure, as well as all linear and portable assets such as trains, ships, offshore rigs, networks and related technology. Widely recognised as a market leader, HabrakenRutten has been part of nearly every significant project in the Netherlands in the past ten years. The firm has unparalleled knowledge of best market practice and the distribution of risk in this sector. HabrakenRutten

has specialists in all aspects surrounding infrastructure, real estate, energy and IT/tech, who represent clients with advice, drafting and negotiation, as well as in litigation and arbitration. The firm's recent track record includes drafting and negotiating a series of "cost-plus" contracts for the renovation of the Binnenhof (the Dutch Houses of Parliament), and the enlargement of the ASML plant in Eindhoven and the Pallas nuclear plant at Petten. The firm is also involved in key tenders in the infrastructure sector.

Authors



Sjoerd Rutten is widely recognised as being one of the leading advisers in contentious matters related to construction. Having maintained a particular focus on construction, project development, public procurement and PPP throughout his career, he is the go-to adviser for contractors, architects, engineers, project developers, sponsors and authorities seeking advice and representation in litigation and arbitration, as well as on dispute prevention. In addition to being a partner at HabrakenRutten, Sjoerd is a member of the editing board of the Magazine for Construction Law and regularly contributes articles to other leading journals. He is also the author of several books on topics within his expertise.



Peter Habraken is a partner at HabrakenRutten and a well-known legal adviser in large projects in the infrastructure, energy/industry, real estate and transport/logistics sectors. His long-standing focus on asset development and involvement in nearly every significant PPP project in the Netherlands ensures that his clients have access to best market practice, as well as practical solutions to unique situations. Appreciated for his commercial approach, clients rely on him to achieve "bankable" legal structures and desired exit strategies, as well as risk management throughout the entire life cycle of a project. Peter is a co-founder and member of the Dutch and German Lawyers Association.

HabrakenRutten

Weena 690
3012 CN Rotterdam
Netherlands

Tel: +31 88 374 4900
Fax: +31 10 412 7941
Email: s.rutten@habrakenrutten.com
Web: www.habrakenrutten.com

HABRAKENrutten

Overview

After the turbulence of recent years, which saw COVID-19 and the Ukraine conflict upsetting the Dutch construction sector, the latest year has been characterised by a somewhat uneasy status quo. The upward price pressure from COVID-19 and Ukraine seems to have petered out. Nevertheless, construction activity has been somewhat muted, especially in the office and residential sectors; in both sectors, this has partly been caused by prevailing interest rates, though some homegrown factors are at work too. Particularly in the realm of taxation, an adverse wind is blowing, and political mood regarding housing is giving way to new, highly debated regulation. These have all put a brake on investment, both in offices and in residential developments. Notably for foreign investors, the Netherlands seems, for the moment, to have been abandoned as an attractive market.

Nonetheless, the construction industry has apparently become more of a sellers' market: competent personnel are in short supply, and, for bigger and more complex projects, it is becoming increasingly difficult to find a builder with capacity available. This is especially the case in the infrastructure market, which recently witnessed a series of aborted tenders, caused

by lack of interest. As a result, public employers seem prepared to loosen contractual conditions.

Finally, politics remains unstable in the Netherlands. The country has been confronted with a more or less "drawn" electoral result and a rather unique right-centre (so-called extra-parliamentary cabinet) catering to the interests of its diverse electorate. If anything, this seems to introduce another source of uncertainty, which will not be beneficial for long-term investment decision-making.

Regulatory and Taxation Issues

The overriding impression of the regulatory "landscape" in the Netherlands is, firstly, of a combination of new – and as yet untested – regulations.

In an ambitious drive, nearly all zoning and planning regulations, as well as environmental regulations, have been restructured, renamed and renewed in a behemoth new legislative package, called the *Omgevingswet* (Environment and Planning Act). In itself, no major material changes are intended; however, a renewed terminology and new procedures have replaced tried and trusted principles, and a lot of confusion and mistakes are to be expected as a result. Moreover, real problems have not been solved and

seem to have been kicked forward – for example, the so-called nitrogen crisis is nowhere near over. The elections appear to have produced a “stand-off” regarding this issue, which may re-affect the sector with a vengeance.

Aside from the foregoing, a strong political drive exists to further regulate – or “reign in” – the housing market. A new “affordable rent law” (*Wet betaalbare huur*) has been sent to parliament, and aims to enlarge the total supply of affordable houses in the rent sector, in effect by curbing (the rise of) rents and by (further) strengthening the positions of tenants. So far, this initiative seems to have discouraged Dutch and international investors in the residential sector; in fact, it has already spurned a wave of divestment, both by smaller and by bigger investors.

In addition, a rather cold fiscal wind seems to be blowing in the Netherlands, and is gathering force. Partly because of budget necessities, partly ideologically driven, a combination of taxation measures may bode bad news for the entrepreneurial sector in general, and for investors in real estate in particular. Taxation of profits – both present and future – is aggravated. Municipal (polling) taxes are rising. A number of tax exemptions (including for real estate investors) have been curbed or abolished altogether. As well as for investors, these measures seem especially prone to harm family-owned businesses – including in retail – which may also have consequences for this sector.

“Gridlock”

A further issue plaguing the real estate development sector is the growing shortage of electricity supply, also known as “net congestion”. Large areas face substantial shortages of electrical capacity. It has become customary for construction companies to exonerate regard-

ing electricity capacity in new projects. Demand has increased sharply and (in part) unexpectedly as a direct result of the energy transition itself (which involves a turn towards electricity and away from, inter alia, natural gas) and of an inadequate grid (which in large part was laid out in the late-1950s and early-1960s).

A catching-up operation is gathering pace, and offers opportunities for construction companies specialising in this area. Furthermore, large institutional investors – eg, pension funds – are also considering stepping in.

Industrialisation and Digitalisation of Building Processes and Big Data

On a positive note, there continues to be rapid development of industrial and digital processes in the Dutch construction sector. All large Dutch construction companies presently have their own factory-produced houses. Some of these can be assembled in one day. Consumers can submit their preferences virtually by laptop, including the tiniest details. This process still suffers from some “growing pains”, but quality is improving fast and traditional building techniques are rapidly becoming a thing of the past.

In design processes, digital solutions have become standard. In the Netherlands, intensive use is made of Building Information Modelling (BIM), a computer model enabling fully digitised 3D designs of existing and new buildings.

The introduction of so-called building-hubs continues – ie, semi-permanent assembly and storage yards in the outskirts or vicinity of big cities. From these hubs, building materials and components are transported “just in time” via zero-carbon electrical vehicles.

The latest development is that large infrastructural companies, as well as real estate constructors, are exploring the possibilities of mining big data, supplied by interactive traffic and asset-monitoring sensors, via the expanding 5G network. Today, it is already possible to lower the entire nitrogen level in a city by connecting measurement data to traffic management installations, in order to reroute traffic in the most environmentally effective way.

Climate Transition

Another positive development is the shift, by number of construction companies, towards working in the energy (infrastructure) sector. As said, it is evident that the so-called climate transition requires a massive rejuvenation and extension of the electricity grids across the line (high voltage, middle voltage and low voltage). With the added migration of natural gas to hydrogen, the demand for renewable energy in solar and wind (both onshore and offshore) and thermal energy storage facilities, this clearly creates a large new market. More and more construction companies are entering this field and are beefing up their installation divisions. Currently, several hydrogen plants (eg, for Shell and BP) are under construction. Even the upgrading and renewal of nuclear capability was recently decided on by the government, allowing for at least two nuclear plants in the Netherlands.

Summary

Prospects for the Dutch construction sector are mixed. New regulation and tax measures are reducing the appetite for investment in Dutch real estate, in addition to an already tense market situation resulting from existing interest rates.

A lot of work is being “heaped” on the construction sector, all in the context of:

- the turning away from natural gas as an energy source;
- the extension of electricity grids;
- the need to cope with uncertain building prospects as a result of the ongoing nitrogen crisis;
- a shortage of skilled personnel; and
- the demand for inventiveness and financial stamina in the sector.

Nonetheless, for the “strong” players, market conditions seem to be good, and improving; and having skilled resources should increasingly prove a strength in its own right.

NEW ZEALAND



Law and Practice

Contributed by:

Anton Trixi, Lauren Whitehead, Geoff Busch and Steve O'Dea
Anderson Lloyd

Contents

1. General p.430

- 1.1 Governing Law p.430
- 1.2 Standard Contracts p.430

2. Parties p.432

- 2.1 The Employer p.432
- 2.2 The Contractor p.433
- 2.3 The Subcontractors p.434
- 2.4 The Financiers p.434
- 2.5 The Designer p.435

3. Works p.436

- 3.1 Scope p.436
- 3.2 Variations p.437
- 3.3 Design p.437
- 3.4 Construction p.438
- 3.5 Site p.438
- 3.6 Permits p.439
- 3.7 Maintenance p.439
- 3.8 Other Functions p.439
- 3.9 Tests p.439
- 3.10 Completion, Takeover and Delivery p.440
- 3.11 Defects and Defects Liability Period p.440

4. Price p.441

- 4.1 Contract Price p.441
- 4.2 Indexation p.441
- 4.3 Payment p.442
- 4.4 Invoicing p.442

5. Time p.443

- 5.1 Planning and Programme p.443
- 5.2 Delays p.443
- 5.3 Remedies in the Event of Delays p.444
- 5.4 Extension of Time p.444
- 5.5 Force Majeure p.445
- 5.6 Unforeseen Circumstances p.445
- 5.7 Disruption p.445

6. Liability p.446

- 6.1 Exclusion of Liability p.446
- 6.2 Wilful Misconduct and Gross Negligence p.446
- 6.3 Limitation of Liability p.446

7. Risk, Insurance and Securities p.446

- 7.1 Indemnities p.446
- 7.2 Guarantees p.446
- 7.3 Insurance p.447
- 7.4 Insolvency p.447
- 7.5 Risk Sharing p.447

8. Contract Administration and Claims p.447

- 8.1 Personnel p.447
- 8.2 Subcontracting p.448
- 8.3 Intellectual Property p.448

9. Remedies and Damages p.448

- 9.1 Remedies p.448
- 9.2 Restricting Remedies p.448
- 9.3 Sole Remedy Clauses p.448
- 9.4 Excluded Damages p.449
- 9.5 Retention and Suspension Rights p.449
- 9.6 Termination p.449

10. Dispute Resolution p.450

- 10.1 Regular Dispute Resolution p.450
- 10.2 Alternative Dispute Resolution p.450

Anderson Lloyd is one of New Zealand's oldest and most respected law firms. It is a unique national firm with four integrated offices (Auckland, Christchurch, Dunedin and Queenstown). Project development, energy, construction and infrastructure are core strengths and Anderson Lloyd is widely recognised for its expertise. The projects team at Anderson Lloyd is based in Auckland, comprising construction, property, banking and finance, and dispute resolution specialists. Recent major projects include KiwiRail's City Rail Link Project and the Wellington

Metro Upgrade, the Waimea Dam, Christchurch City Council's Ngā Puna Wai sports hub, Te Tai Tokerau Water Trust's Mid-North Water Scheme and Kaipara Water Scheme, Timaru District Council's Theatre Royal and multi-purpose Heritage Hub upgrade, Harmony Energy's Tauhei Solar Farm, the NZD1 billion suite of solar photovoltaic projects by Far North Solar Farm and Aquila Capital, Tilt Renewables' Waipipi wind farm and Mercury's Kaiwaikawe and Kaiwera Downs wind farms.

Authors



Anton Trixl is a partner at Anderson Lloyd and a specialist in the energy, natural resources and infrastructure sectors. Since 2004, he has been advising clients on transactions in these

sectors in more than 30 countries, including project development and project financing, PPPs, M&A, joint ventures, construction and a wide variety of commercial contracts. After more than ten years with law firms in Wellington, Dubai and Singapore (including seven years with Clifford Chance in Dubai and Singapore), Anton joined Anderson Lloyd in March 2015. He is a member of the Society of Construction Law New Zealand.



Lauren Whitehead is a partner at Anderson Lloyd and specialises in infrastructure and construction projects, having moved back into private practice after four years at KiwiRail

(recently as acting general counsel). Since 2007, she has advised on construction and projects (including PPPs while at Herbert Smith Freehills in Sydney) across a variety of sectors such as rail, roading, housing, telecommunications, defence, and other social infrastructure (prisons, social housing and waste management). In addition to her front-end work, Lauren has advised on dispute resolution – including class actions and mass torts – and she is a trained mediator in New York and Australia.



Geoff Busch is a partner at Anderson Lloyd and heads the firm's banking and finance team. He has particular expertise in acquisition, project, corporate, structured and property finance

and debt capital markets transactions. Geoff regularly acts for international and domestic banks, financial institutions and borrowers/issuers on high-profile transactions across a range of sectors. He also provides general banking and finance advice, including advising on debt restructuring and insolvency and financial services regulatory issues. Geoff has practiced for 30 years in Auckland, London and Sydney, and became a law firm partner in 2004.



Steve O'Dea is a special counsel and a specialist in infrastructure and construction transactions, project delivery and dispute resolution. For more than a decade, he has advised

on transactions, project management, and disputes in a range of commercial sectors in multiple jurisdictions, including major energy and infrastructure projects, construction, PPPs, corporate and commercial matters, and IP and technology matters. Steve relocated from London in 2017 to join Anderson Lloyd's commercial team. He is admitted as a solicitor in England and Wales and New Zealand, and is a member of the Society of Construction Law New Zealand.

Anderson Lloyd

Level 3
Australis Nathan Building
37 Galway Street
Britomart
Auckland 1010
New Zealand

Tel: +64 9 338 8300
Fax: +64 9 337 1115
Email: lawyers@al.nz
Web: www.al.nz

**anderson
lloyd.**

1. General

1.1 Governing Law

Legal Framework

The principal laws governing New Zealand's construction industry are found in statutes and common-law authorities. Common-law authorities from similar overseas jurisdictions are not binding in New Zealand, yet are often influential.

Key Statutes

Building Act 2004

This is the primary legislation governing the building industry. Its stated purpose is to provide that people can use buildings safely and without endangering their health. The Building Act 2004 provides the legal framework for the building code, which sets out the standard required for buildings in New Zealand and guidance for how to meet those standards. The Building Act 2004 also contains minimum mandatory warranties for building work in relation to household units.

Construction Contracts Act 2002 (CCA)

The CCA is predominantly concerned with regular and timely payments between the parties to a construction contract, given the importance of cash flow for contractors. The CCA:

- governs the requirements for parties holding retentions;
- provides for a fast-track dispute resolution mechanism (adjudication) for construction disputes and claims;
- prohibits "pay when paid" or "pay if paid" terms in construction contracts; and
- provides a default payment process of payment claims and payment schedules for construction contracts.

Health and Safety at Work Act 2015

This law outlines the standard needed at work sites to ensure personnel are safe. The Health and Safety at Work Act (HSWA) also controls how this standard is measured and enforced.

Resource Management Act 1991 (RMA)

The RMA promotes the sustainable management of natural and physical resources. A construction project may need a resource consent to develop or use natural and physical resources or carry out activities that affect the environment. If a consent is granted, it will impose conditions on such use or activities. The RMA regulates this process.

1.2 Standard Contracts

There are no mandatory contracts for construction projects in New Zealand. However, there are common and standard form New Zealand contracts for construction and for key construction consultants.

The New Zealand Standard (NZS) Series of Construction Contracts

The two most common standard form contracts for construction are provided by Standards New Zealand.

NZS 3910 – Conditions of contract for building and civil engineering – Construction

This is a "construct-only" contract where the employer provides the design and the contractor is responsible for the construction component of the project.

NZS 3915 is a similar "construct-only" contract and it is sometimes used instead of NZS 3910 on projects where there is no "engineer" (see 2.1 The Employer).

In late 2023, Standards New Zealand published the latest edition of this “construct-only” contract (NZS 3910:2023). This introduces important changes, including replacing and splitting the role of the “engineer to contract” (see **2.1 The Employer**).

NZS 3916:2013 – Conditions of contract for building and civil engineering – Design and construct

This is a “design-and-build” contract where the employer provides its requirements and the contractor is responsible for both the design and construction of the project.

Design, which is the key distinction between NZS 3910:2013 and NZS 3916:2013, is discussed further in **3.3 Design**.

Other Standard New Zealand Construction Contracts

Other standard form contracts found in New Zealand include the following.

The New Zealand Institute of Architects (NZIA) forms of contract

- Standard Construction Contract (used when the architect administers the construction contract).
- National Building Contract (used when the architect is not contractually involved in the administration of the construction contract).

The Registered Master Builders Association forms of contract

- Residential Building Contract (RBC1) (usually for residential construction projects).
- Subcontract Agreement (for use between contractors and their subcontractors).

Overseas Forms of Construction Contracts Commonly Used in New Zealand

Several overseas forms of construction contract are commonly used in New Zealand, including:

- the British New Engineering Contracts (commonly NEC3 and NEC4);
- the suite of contracts from the International Federation of Consulting Engineers (*Fédération Internationale des Ingénieurs-Conseils*, or FIDIC), most commonly:
 - (a) Conditions of Contract for Construction (the “Red Book”);
 - (b) Conditions of Contract for Plant and Design-Build (the “Yellow Book”); and
 - (c) Conditions of Contract for Engineering, Procurement and Construction (EPC)/Turnkey (the “Silver Book”).

Standard New Zealand Construction Consultancy Contracts

The most common forms of consultancy contract for construction professional services are:

- the Conditions of Contract for Consultancy Services (CCCS), and an associated long form contract developed by Engineering New Zealand and the Association of Consulting Engineers New Zealand (ACENZ), and an associated short form contract used for a wide range of construction consulting services;
- the Agreement for Architects Services (AAS), used for professional design services; and
- the Contract for Quantity Surveying Consultancy Services (CQSCS), used by members of the New Zealand Institute of Quantity Surveyors (NZIQS).

2. Parties

2.1 The Employer

Nature of Employers

The employer – known as “the principal” in NZS contracts – can be a wide range of persons, including:

- a local council or central government body;
- an incorporated or unincorporated entity – for example, in industries such as manufacturing, residential and commercial real estate, and irrigation; or
- individual persons (eg, for home builds and renovations).

Engineer as a Key Agent of Employers

The main NZS forms of contract include the concept of “the engineer to contract”, which is similar to the engineer in the FIDIC series of contracts. The latest NZS 3910:2023 has replaced the role of the engineer with two new roles: a contract administrator and an independent certifier.

In NZS contracts with an “engineer”, the engineer administers the contract and has a dual role as an agent of the employer and a quasi-independent decision-maker. In the latter role, the engineer is expected to act fairly and impartially.

In NZS contracts with a contract administrator and independent certifier:

- the contract administrator administers the contract and acts as an agent of the employer, handling day-to-day matters and issuing instructions; and
- the independent certifier acts as an independent decision-maker, who is required to act fairly, impartially and independently of either contracting party in making decisions

under the contract, and who is the agent of the employer only for receiving payment claims, incorporating the employer’s deductions into payment schedules, and issuing payment schedules.

Many roles of the employer referred to in this guide will actually be performed by the engineer, contract administrator, or independent certifier (eg, issuing and assessing variations or extensions of time and confirming works are complete).

General Rights and Responsibilities of Employers

Common rights of the employer are:

- to have the contractor perform the works so they meet the requirements in the specifications and drawings;
- to vary the works (subject to awarding extensions of time and additional costs to the contractor where appropriate);
- to have the works performed within a specified timeframe (subject to extensions of time in particular circumstances); and
- to have the works be free of defects and to have the contractor remedy defects within a reasonable timeframe.

The employer is typically responsible for:

- setting out its requirements for the project (including providing the design and specifications, where applicable – see 3.3 Design);
- having/arranging funding for the project and paying the contractor within the agreed timeframes;
- securing building consents and resource consents for the project; and

- providing access to the site and avoiding interfering with the contractor's performance of the works.

Relationship Between Employers and Contractors

The employer and contractor will be the parties to the construction contract. The contractor must carry out the works specified in that contract and the employer must pay for those works under the contract.

It is common for the employer to require security from the contractor to ensure the due, proper and punctual performance of the contractor's obligations under the contract. This is usually achieved through a contractor's performance bond and retentions from payments due to the contractor.

Once the contract is under way, the employer and contractor usually each have a single nominated representative to facilitate clear communication.

Relationship Between Employers and Subcontractors

See 2.3 The Subcontractors.

Relationship Between Employers and Financiers

See 2.4 The Financiers.

2.2 The Contractor Nature of Contractors

There is significant variability in the size and nature of contractors commonly operating in New Zealand. Contractors range from large listed corporations (both local and overseas) to much smaller private companies. It is not unusual for larger projects in New Zealand to involve

overseas organisations (often in a joint venture with local entities).

Common Rights and Responsibilities of Contractors

Common rights of the contractor are:

- to choose its preferred methodology for performing the works (often within specified parameters);
- to receive payment from the employer within the agreed timeframes;
- to receive additional payments and extensions of time for a specified range of events (typically circumstances beyond the contractor's control); and
- to perform the works without being prevented from doing so by the employer or third parties.

Common responsibilities of the contractor are:

- performing the works so they meet the requirements in the contract (including requirements in the design and specifications, where applicable – see 3.3 Design);
- completing the works within a specified timeframe (subject to extensions of time in particular circumstances); and
- ensuring that the works are free from defects and remedying such defects for a specified timeframe after the completion of the works.

Contractors are not relieved from their responsibilities to the employer if they subcontract works to third parties.

Relationship Between Contractors and Employers

See 2.1 The Employer.

Relationship Between Contractors and Subcontractors

See 2.3 The Subcontractors.

Relationship Between Contractors and Financiers

See 2.4 The Financiers.

2.3 The Subcontractors

Nature of Subcontractors

Subcontractors can be local, national or overseas entities and typically specialise in specific trades.

Common Rights and Responsibilities of Subcontractors

The rights and responsibilities of subcontractors are generally akin to the rights and responsibilities between a contractor and the employer. See 2.2 The Contractor.

Relationship Between Subcontractors and Employers

By default, owing to privity of contract, the employer does not form a relationship with the contractor's subcontractors. However, through its contract with the contractor, the employer typically places controls on subcontracting, such as:

- requiring consent to subcontract works of more than a specified value;
- requiring particular sets of work to be performed by specified subcontractors; and
- permitting the employer to make direct payments to a subcontractor in particular circumstances (eg, if an undisputed amount remains unpaid).

It is not unusual for employers to have limited rights regarding certain subcontract works by virtue of:

- direct warranties – where the subcontractor provides a warranty to the employer (usually by deed) for specified works or materials; and
- subcontractor continuity guarantees – where subcontractors agree to work directly for the employer where the contract between the subcontractor and the contractor ceases to be viable (eg, owing to termination or contractor insolvency).

Relationship Between Subcontractors and Contractors

Subcontractors are engaged on a construction project through a subcontract with the contractor. It is customary for a contractor to engage a variety of subcontractors, each with a specific trade, on a single project.

A subcontractor's scope of responsibility is generally limited to the work and risks outlined in its subcontract with the contractor. However, often a contractor seeks to pass risks in its contract with the employer down to the relevant subcontractor.

Relationship Between Subcontractors and Financiers

See 2.4 The Financiers.

2.4 The Financiers

Nature of Financiers and the Financing of Projects in New Zealand

Financiers of construction projects in New Zealand are usually local and foreign commercial banks, investment banks and institutional investors (such as pension funds). Multi-financier syndicates are common in larger projects.

Rights and Obligations of Financiers

Financiers must provide financing to the employer, but will not be party to the construction contract itself or otherwise have direct obligations

to the contractor. However, they may receive the benefit of undertakings from the contractor under a direct deed – as noted in the description of the relationship between financiers and contractors further on in this section.

In traditional construction financings, financiers take security over physical assets such as land and buildings, as well as over construction contracts and other material contracts such as sale agreements or leases. They may also receive the benefit of a guarantee from a parent company guaranteeing repayment of financing provided to its subsidiary or take security over the shares in the employer held by its shareholder(s).

In limited recourse project financings, the security package may be similar. However, the financiers will have a significantly enhanced focus on the cash flows arising from the operation of the completed project. They will exercise a much higher degree of diligence in assessing and monitoring matters arising under the construction contract and related contracts (such as completion guarantees), as the achievement of completion under the construction contract will unlock the cash flow.

Relationship Between Financiers and Employers

The relationships between financiers and employers under construction projects are governed by the relevant finance and security documents. These will typically comprise a facility agreement and a general security agreement (providing for “all assets” security over the employer) and one or more specific security agreements – for example, providing for an assignment by way of security of specific project contracts or for security over the shareholder’s shares in the employer – or guarantees.

Relationship Between Financiers and Contractors

On financed projects it is common for a direct deed to be agreed between the financier, the employer and the contractor. A direct deed generally requires the contractor to:

- consent to the security given to the financier over the construction contract;
- agree that certain insolvency actions (such as appointing a receiver) will not in themselves trigger a contractor’s right to terminate the construction contract;
- agree to give the financier additional cure periods to remedy a default of the employer under the construction contract that could otherwise lead to termination by the contractor; and
- pre-agree the basis on which the financier may sell the benefit of the construction contract or of the shares in the employer to a third party on enforcement of its security.

Relationship Between Subcontractors and Financiers

It is rare for financiers and subcontractors to have a direct contractual relationship.

2.5 The Designer

The designer of construction projects in New Zealand prepares the plans and specifications for building work and is responsible for the building work’s compliance with the building code.

There is significant variability in the size and nature of consultancies offering design services operating in New Zealand. Design consultants range from large listed corporations (both local and overseas) to much smaller private companies. Such consultancies will offer some or all of the range of architectural and engineering

services required for the design of construction projects.

If a designer is responsible for the design of restricted building work, then the designer must be appropriately licensed and this is regulated under the Building Act 2004.

Common Responsibilities and Obligations of Designers

The designer's principal statutory responsibility (under Section 14D Building Act 2004) is to ensure that their advice or plans and specifications, if followed, will result in building work compliant with the Building Code. This design responsibility applies to all building work. Under their design contracts, designers also commonly have an obligation to prepare a design that meets their client's brief and to prepare the designs using reasonable care and skill.

In the design stage, the designer must meet its obligations under the Health and Safety at Work Act 2015 to foresee and manage potential health and safety risks for end users. This includes, so far as is reasonably practicable, the responsibility for:

- ensuring that structures, plant and substances are without health and safety risk;
- carrying out tests to ensure the structure, plant or substance they have designed is without risk;
- providing all relevant information about their designs;
- consulting, co-operating and co-ordinating with other persons conducting a business or undertaking (PCBU); and
- ensuring their designs comply with all relevant legislation.

Relationship Between Designers, Employers and Contractors

The relationship between the designer, employer, and the contractor will depend on the construction contract used.

For a construct-only contract (eg, a 3910), the designer would have a design consultancy contract with the employer and there will be no contractual relationship between the designer and contractor. However, designers owe a duty of care to the occupiers, owners, and subsequent purchasers of the building, and may be sued in tort for a breach of this duty of care.

In a design-and-build contract (eg, a 3916), the designer will have a relationship with the contractor. The contractor will often subcontract to a designer to provide services based on the employer's brief or use an in-house designer. The employer will not have a contractual relationship with the designer unless the employer and designer enter into a direct deed.

These frameworks for allocating design responsibilities and risk between the employer and contractor are discussed in 3.3 Design.

3. Works

3.1 Scope

Sources and Descriptions of the Scope

The scope typically constitutes:

- "requirements" in a design-and-build contract, where the employer sets out the parameters and minimum obligations of the works to be performed by the contractor; or
- "specifications" in a construct-only contract, where the employer sets out in much more

granular detail what the contractor must provide.

Both requirements and specifications can also contain drawings setting out the locations, dimensions, forms and finishes required. Drawings are typically much more detailed in a construct-only contract.

Scope in Tenders

The employer will set out its requirement for the works (conventionally known as the “scope or specifications”) in a closed or open tender process. Often the contractor and employer negotiate that scope (eg, to reduce the price) before the contract is finalised and executed.

Scope in Contracts

Once the contract is executed, the scope is generally fixed and can only be modified thereafter if – and to the extent – permitted by the contract itself (see 3.2 Variations).

3.2 Variations

Instructing Variations

The scope of an instructed variation is usually at the sole discretion of the employer and, in NZS contracts, a variation is usually instructed by the engineer (or contract administrator in NZS 3910:2023). In New Zealand, contracts typically permit the employer/engineer/contract administrator to:

- increase or decrease the quantity of work;
- omit any work (although major omissions may be deemed repudiation or termination);
- change the character or quality of any material or work; or
- change the level, position, dimensions, specifications, or any other part of the contract works.

Some events or circumstances are often variations, even though they do not arise from an instruction from the employer/engineer/contract administrator – for example, unforeseen ground conditions and archaeological discoveries.

Valuing Variations

The process for valuing variations differs across contracts. In New Zealand, particularly in NZS contracts, valuation is established by one of the following methods (in descending order of precedence):

- by agreement;
- by application of rates and prices in the contract;
- by application of rates and prices derived from similar rates in the contract; or
- by assessment of net cost.

Where rates do not include overheads and margins, or if the variation is valued on a net cost basis, allowances for overheads and margins are usually added.

Where variations prolong the works, time-related costs may apply (see 5.2 Delays).

3.3 Design

In New Zealand, the two most common frameworks for allocating design responsibilities and risk are the following.

Construct Only

The contractor is responsible for its method of construction based on the design, but not for errors or omissions in the design.

Between the contractor and the employer, the design risk sits with the employer except when this design relates to the contractor’s methodol-

ogy or temporary works (for which the contractor has design responsibility).

The employer usually allocates the design risk separately by contract to a designer. The designer's duty is only to the employer and the designer has no contractual responsibilities to the contractor.

NZS 3910 is frequently used for such contracts.

Design and Construct

The contractor is responsible for both the design and construction of the works (if the owner has a pre-existing design, it may be novated to the contractor).

Between the contractor and the employer, the design risk sits with the contractor.

Contractors without in-house design resources typically subcontract the design aspects of such projects.

NZS 3916 is often used for such contracts.

3.4 Construction

The employer's role during the construction itself is mostly limited to providing site access to the site for the contractor and its subcontractors. However, the employer may have to provide supplementary information or design clarifications when requested by the contractor.

The contractor usually has the autonomy and primary obligation to:

- select the appropriate construction methodology;
- source the materials and resources; and
- manage and perform the construction works.

Subcontractors are managed by the contractor and have a similar role to the contractor regarding their subcontracted works.

3.5 Site

The employer is responsible for making the site available to the contractor by a particular date to perform the works.

For geotechnical site conditions, responsibility and risk can vary significantly by contract. Ordinarily, the employer will bear the risks of adverse conditions unless:

- those conditions have been disclosed to the contractor;
- the contractor has had the opportunity to investigate those conditions before pricing;
- the conditions could have been foreseen by an experienced contractor; or
- the contractor accepts the risk.

Contamination

Pre-existing contamination is usually the employer's responsibility, whereas the contractor is responsible for ensuring that it does not contaminate or pollute the site during construction.

Pollution and contamination are governed by the Resource Management Act 1991, the resource consent for the relevant project, and often local council guidelines.

Archaeological Finds

Archaeological discoveries, and any delays and additional costs caused by such discoveries, are mainly the employer's responsibility.

Archaeological finds on a construction site are governed by the Heritage New Zealand Pouhere Taonga Act 2014, which requires that no per-

son may modify or destroy a site if that person knows – or ought reasonably to have suspected – that the site is an archaeological site.

3.6 Permits

Common Permits

The following permits are generally required for construction projects in New Zealand:

- resource consent – authorisation to develop or use natural and physical resources or carry out activities that affect the environment;
- building consent – authorisation to carry out building works in a specific way that complies with the building code;
- code compliance certificate – confirmation, once the work is completed, that the work performed complies with its building consent and the building code; and
- certificate of public use – an interim permit for members of the public to use a premises until the code compliance certificate is issued.

Responsibility for Permits

Arrangements for permits vary by contract. Usually:

- the employer obtains the resource consent;
- the party responsible for the design obtains the building consent; and
- the contractor obtains any permits/licences for its temporary works and services and for the operation of its machinery.

3.7 Maintenance

Most construction contracts exclude general maintenance obligations after completion. These become the employer's responsibility.

Typically, the employer will either self-perform maintenance works or enter into separate maintenance service agreements with third parties

for the proper operation and maintenance of the works. The NZS 3917 fixed-term contract is available for such maintenance services.

For defects in construction works arising after practical completion, see **3.11 Defects and Defects Liability Period**.

3.8 Other Functions

Finance and maintenance primarily sit outside the construction contract between the employer and the contractor. See **2.4 The Financiers** and **3.7 Maintenance**.

3.9 Tests

Some projects require key materials or equipment to be tested to ensure that they meet contractual or regulatory requirements.

The processes vary by contract. The contractor will typically give the employer notice of the date when it will be ready for such tests to be carried out. The contractor will then carry out the tests or arrange for the tests to be performed by specialists, with the employer having the right to attend (or to have an agent attend) such tests.

There are numerous potential testing types and stages, including:

- factory acceptance tests – tests in the factory itself to ensure that equipment works as expected or that materials have the specified qualities;
- tests on completion – tests after the works have been installed and commissioned, before completion is certified, to ensure that works conform with the standards required by the contract;
- tests after completion – ensure the work continues to meet the standards required by the contract (eg, to ensure ongoing reliability) and

to demonstrate that the performance guarantees specified in the contract have been attained; and

- discretionary tests – some contracts in New Zealand allow a representative of the employer to perform tests if they have concerns regarding an aspect of the works and any costs/delays resulting from those tests are borne by either:
 - (a) the employer (if the works meet contractual requirements); or
 - (b) by the contractor (if the works are found not to meet contractual requirements).

3.10 Completion, Takeover and Delivery Completion/Taking Over

Most standard forms set out a process for verifying/delineating when works are completed/taken over. In some contracts this can be a multi-stage process, including:

- practical completion – when works are largely complete apart from minor defects/snags that do not prevent occupancy/use of the works; and
- final completion – when works are complete and all defects have either been remedied or accepted.

For construction contracts, the employer (or, more likely, its engineer/independent certifier) will typically inspect the works and issue a practical completion certificate, followed later by a final completion certificate, certifying the works meet the requirements of the contract.

However, there are also some actions (eg, taking possession and using the works before practical completion) that can result in the employer being deemed to have taken over the works.

Delivery

The term delivery is typically used for materials or equipment and is often linked to obligations to make payment and the transfer/allocation of risk or title.

In New Zealand, the point of delivery will usually be expressly stated in the contract. The International Chamber of Commerce's Incoterms rules are not mandatory but are frequently referred to for international deliveries.

3.11 Defects and Defects Liability Period

Most construction contracts have a limited period after the works are completed (typically ranging from a few months to one to two years), within which the contractor must remedy any snags/defects. This is known as a defects notification period (DNP). In addition, the employer will often require various standalone warranties for defects arising after the DNP.

Common standalone warranties relate to key materials/equipment remaining defect-free and the weather-tightness of the works. NZS forms of contract include some standard form warranties as a schedule to the main terms.

Defect Notification Periods

If a defect or fault emerges during a defect notification period because of defective workmanship or materials, the contractor must remedy the defect or fault. If the contractor does not remedy the works within a reasonable time, the employer may engage third parties to remedy the works and then recover the cost of doing so from the contractor.

Employers often retain some of the contract price as a retention until the end of the DNP to incentivise the contractor to return to fix such

defects (and thereby ensure the payment of the retentions to the contractor).

Statutory Warranties

Under the Building Act 2004, residential building work is covered by a ten-year warranty that building work will be carried out with reasonable care and skill – complying with plans and the building consent – and that the building materials will be suitable for the purpose for which they are to be used. Parties cannot contract out of this warranty.

4. Price

4.1 Contract Price

Cost Structures

The following structures are among those used most frequently to price construction projects, and some projects use a combination of these pricing structures.

- Lump-sum contracts – a fixed price for a defined scope of work. However, the price may change if the owner alters the design/works, or if unexpected circumstances are encountered.
- Measure and value – a schedule of prices is usually agreed at the outset (eg, a rate per unit of work) and the quantity of work is then measured/assessed and paid accordingly.
- Cost reimbursement – the employer pays the contractor the net costs plus a pre-agreed margin. This is rarer than the above-mentioned options, owing to the lack of cost certainty and control.
- Target cost – before signing the contract, parties will outline the target cost of the project. It is normal for parties to agree to a structured formula to estimate the cost of the project. At practical completion, if there are any savings

or cost overruns, the balance will be shared between the employer and contractor under the percentages stated in the contract.

- Alliances and other forms of collaborative contracting are not uncommon on major projects.

Payment Structures

In New Zealand, project payments are usually based on either:

- progress – payments are based on the percentage of completed work; or
- milestones – payments are made when key stages of a project are achieved.

4.2 Indexation

Indexation of prices for construction projects depends on the form of contract.

The NZS 3910 (construct-only) and NZS 3916 (design-and-build) contracts contain an opt-out cost fluctuation mechanism to compensate for the effects of inflation. The default structure is an adjustment based 40% against labour indexes and 60% against materials indexes, which reflects the typical distribution of costs in a construction project.

Stats NZ releases price indexes for the construction industry, including the “labour cost index” and the “producer price index – construction input index”. The indexation formulas used in the NZS 3910/3916 cost fluctuation formula are based on these indexes rather than the actual costs incurred by the contractor.

The percentages can be adjusted depending on the relative proportion of labour and materials.

Risk for Price Fluctuations

NZS contracts have an opt-out cost fluctuation provision and it is relatively common for parties to opt out. However, cost fluctuation provisions are more commonly accepted during periods of high cost volatility (or for materials with high cost volatility, if such pricing cannot be fixed or hedged).

If the parties do not allow for cost fluctuation under the contract, then the contractor cannot recover increases in costs (including labour and materials) unless a relevant variation has occurred. Sometimes contracts will allow fluctuations for only a certain type of material used, such as diesel fuel or asphalt.

4.3 Payment

Advance Payments

Advance payments are common in New Zealand for long lead items and recently have been used more frequently to lock in costs and reduce the risk of shipping delays.

If materials are to be paid for before they arrive on site, separate agreements for off-site materials are often entered into to allocate the relevant risks and obligations. NZS forms of contract include a standard form off-site material agreement as a schedule to the main terms – although this is often amended.

Employers also often protect their interests in high-value advance payments by way of advance payment bonds.

Progress Payments

Typically, at regular intervals, the contractor submits a payment claim. The employer will then assess the claim and issue a payment schedule of amounts that it considers to be due.

Late Payments

Construction contracts in New Zealand generally include interest on late payments.

The Construction Contracts Act 2002 has default payment structures intended to ensure regular cash flow throughout the industry. If a qualifying payment claim/invoice (see 4.4 Invoicing) is not appropriately disputed in a payment schedule and is then late/unpaid, this law enables a contractor to:

- suspend work after giving notice; or
- issue a statutory demand for payment.

4.4 Invoicing

Requirements for Tax Invoices

In New Zealand, an invoice will commonly include:

- the words “tax invoice” or “taxable supply information”;
- the name and Goods and Services Tax (GST) number of the provider;
- the date of issue; and
- a description of the goods or services.

New tax laws took effect on 1 April 2023, which amended the rules relating to invoicing and record keeping. The requirement for tax invoices has been updated to a more flexible obligation to provide and keep certain records known as “taxable supply information”. However, Inland Revenue has stated that businesses will not need to change their existing “tax invoice” terminology, and that invoicing practices compliant with the old rules will also comply with the new rules. References to a “tax invoice” can be read as “taxable supply information” (s19Q(1) Goods and Services Tax Act 1985).

Recommended Requirements for Construction Invoices

To benefit from the Construction Contracts Act (see 4.3 Payment), a payment claim/invoice should:

- be in writing;
- identify the construction contract to which the payment relates;
- identify the construction work and the relevant period to which the payment relates;
- state the amount to be paid and the due date for payment;
- indicate how the payee calculated the claimed amount; and
- state that it is made under the Construction Contracts Act.

A payment claim must also be accompanied by an outline (in a prescribed form) of the process for responding to the claim and the consequences of not responding or paying the relevant amount.

Invoices issued after payment claims are mainly a formality to reflect the outcome of the payment claim and payment schedule process.

5. Time

5.1 Planning and Programme Role of and Responsibility for Construction Programmes

In New Zealand, a programme is usually prepared by the contractor at the outset of a project and it is often integral to setting up a project for success. The programme is often reviewed by the employer, who may provide comments/input, but good programming is ultimately the contractor's responsibility.

Many contracts require the contractor to report against and update the programme regularly throughout a project.

Standard Programme Requirements

Standard contractual requirements for a programme are that it should set out:

- the proposed sequence of works and start/end dates of the component activities, demonstrating how the contractor proposes to meet the due dates for completion;
- the critical path and dependencies between activities; and
- the dates by which the contractor requires access to specific areas of the site and any materials, services, or work to be provided by the employer.

5.2 Delays

If a delay occurs, standard contracts in New Zealand include a process along these lines:

- the contractor must notify the employer/engineer, often within a specified timeframe, and outline the cause and effect of the delay;
- the employer will assess the extent of the delay and determine the extension of time it considers appropriate (the employer/engineer is generally required to act reasonably when making this assessment); and
- the dispute resolution procedure will apply if the parties disagree on the appropriate length of the extension of time.

There is an expectation in New Zealand that contractors will take reasonable measures to avoid potential delay events and mitigate to delays. In standard form contracts, failure to give notice can affect the contractor's eligibility for extensions of time and variations if it deprives the

employer of the opportunity to avoid or mitigate the delay.

Delay can cause additional costs for a contractor and losses for an employer. The responsibilities and remedies for such costs and losses (typically residing with the party responsible for those delays) and the applicable approach to concurrent delays are described in **5.3 Remedies in the Event of Delays**.

5.3 Remedies in the Event of Delays

Contractor Delays

If the contractor is responsible for the delay, then contracts often provide that the contractor:

- will be liable for damages for the period between the due date for completion and actual completion, with contracts in New Zealand typically specifying a sum of liquidated damages per day/week; or
- must expedite the works at its cost to make up the lost time.

Employer Delays

If the employer is responsible for the delay, then contracts ordinarily provide that the employer will:

- allow more time for the contractor to complete the work; and
- pay the additional costs arising from the prolongation of the work (either based on reasonable assessment of that cost or a fixed working day rate).

Concurrent Delay

There is no single accepted definition of concurrent delay in New Zealand. However, the essence of concurrent delay is where the employer and the contractor each cause overlapping delay to the critical path of the works.

New Zealand courts are yet to address concurrent delay. Nonetheless, they will likely adopt the approach set out in the High Court of England and Wales decision in *Henry Boot Construction (UK) Ltd v Malmaison Hotel (Manchester) Ltd* (1999) 70 Con LR 32. The Malmaison approach to concurrent delay is that the contractor is entitled to receive an extension of time for the full period of delay – but not prolongation costs – for the period of concurrency. However, under the principle of freedom of contract, the parties may agree to an alternative approach.

5.4 Extension of Time

Contractors usually issue notices for extensions of time to the employer/engineer (independent certifier in NZS 3910:2023) in writing.

In such notices, contractors often must set out the contractual basis for an extension of time claim under the contract.

Grounds for an Extension of Time

Common grounds for an extension of time claim include:

- the effects of variations;
- weather;
- events that an experienced contractor could not foresee at the time of its tender;
- defaults by the employer under the contract; and
- some force majeure-type events, such as flood, volcanic, or seismic events.

Measuring an Extension of Time

Extensions of time are usually measured by determining the extent to which the event or circumstance qualifying as a ground for an extension of time has caused (or will cause) a delay to the contractor's activities or to the critical path

(depending on the exact requirements of the contract).

There is a wide range of prospective and retrospective methodologies for measuring delay, and no particular methodology is mandated by statute. Standard form New Zealand contracts do not specify a particular delay analysis methodology. The choice of methodology is usually left to the discretion of delay experts. Often such experts, and the parties, refer to the Delay and Disruption Protocol published by the Society of Construction Law. However, the protocol provides only non-binding guidance.

Key evidence required for the assessment of delay commonly includes the programme(s) for the contract works and contemporary evidence of the delay such as instructions, site notes, photos, timesheets, minutes of meetings, and communications between the parties.

5.5 Force Majeure

In New Zealand, force majeure only applies if and to the extent that it is expressly included in the contract.

Force majeure clauses are not included in most New Zealand construction contracts as standard. However, most standard form contracts include some relief for events that would usually be considered force majeure events and force majeure clauses are occasionally added to standard form contracts as special conditions.

Force majeure clauses may suspend or excuse the non-performance of contractual obligations during the effect of the force majeure event. They may also permit termination of the contract if the effect of the force majeure event extends beyond an agreed duration.

5.6 Unforeseen Circumstances

Relief for unforeseen circumstances is normally only available if it is included in the contract. However, New Zealand recognises the common-law concept of frustration, which can apply in some instances of unforeseen circumstances. Frustration is grounds for termination under NZS 3910 and NZS 3916 contracts.

In standard form contracts in New Zealand, a contractor is entitled to additional time for unforeseen circumstances but not necessarily additional costs.

5.7 Disruption

Disruption is an interruption to or hindrance of a contractor's intended methodology, resulting in loss of productivity and efficiency. Disruption is recognised as a concept in New Zealand, but disruption claims and associated remedies are only available if allowed for under the particular contract and if the requirements of that contract have been met.

There is no universal method for demonstrating disruption. However, a popular method is the "measured mile" approach, where a contractor demonstrates the productivity it was capable of in portions of the project/site that did not experience disruption and then causally links a disruptive event with the lesser productivity achieved in the affected portion of the works.

Productivity-based approaches, which often use comparative projects and industry standards to establish achievable baselines "but for" the disruption, are also recognised. Alternative cost-based methods – where contractors compare estimated costs with actual costs – are possible but comparatively difficult to causally link with disruptive events, owing to the potential for tender insufficiency as an alternative cause.

6. Liability

6.1 Exclusion of Liability

Warranties under the Building Act 2004 cannot be contracted out of for residential construction. On policy grounds, a person cannot exclude liability for their own fraud.

6.2 Wilful Misconduct and Gross Negligence

The concepts of wilful misconduct and gross negligence are not well-established in the New Zealand courts. However, where contracts include limitations on liability (see **6.3 Limitation of Liability**), such clauses often seek to ensure that any limitation of liability does not apply if the contractor engages in wilful misconduct or gross negligence.

6.3 Limitation of Liability Consumer Contracts

In consumer contracts in New Zealand, limitations of liability are restricted by the Consumer Guarantees Act 1993. By way of example, a contractor cannot limit its liability for completing construction with reasonable skill and care, so it is fit for purpose and on time or within a reasonable timeframe.

Commercial Contracts

In *CBL Insurance Ltd (Liq) v Harris* (2021) NZHC 1393, the High Court confirmed that clear limits of liability are enforceable in commercial contracts in New Zealand. Limitations of liability are not included in New Zealand's most common standard form contracts (other than NZS 3910:2023 which includes this as an option); however, it is not unusual for parties to add such clauses.

7. Risk, Insurance and Securities

7.1 Indemnities

Parties are mostly free to negotiate indemnities subject to policy restrictions – for example, not indemnifying certain court issued fines and penalties. Standard form contracts in New Zealand typically include indemnities:

- from the contractor to the employer for losses:
 - (a) arising out of acts or omissions by the contractor in executing the contract works, or any negligence or breach by the contractor;
 - (b) for remedying defects in the construction; and
 - (c) injuries to persons or damage to property; and
- from the employer to the contractor for losses:
 - (a) arising from the employer's lack of rights to carry out construction on the site;
 - (b) arising from acts or omissions of the employer (albeit NZS 3910:2023 has removed this indemnity); and
 - (c) injuries to persons or damage to property.

It is not uncommon for parties to agree to further indemnities (to the extent permitted by law) for:

- infringement of third-party IP rights;
- infringement of law, including the Building Act 2004 or Resource Management Act 1991; and
- breach of confidentiality (if applicable).

7.2 Guarantees

There are no mandatory guarantees in New Zealand. However, several forms of performance guarantees are used frequently in the New Zea-

land market, such as bonds and parent company guarantees.

Bonds

Standard form contracts in New Zealand anticipate performance bonds. These are usually provided by the contractor to the employer as security for performance of the contractor's obligations, although NZS 3910/NZS 3916 also include an option for a bond to be provided by the employer to the contractor (rarely used).

Parent Company Guarantees

If the contractor is a subsidiary and has limited assets, the employer may require (and financiers may expect) performance to be assured by way of a guarantee from a parent company.

7.3 Insurance

In NZS forms of contract, four types of insurances are usually taken out by the parties:

- construction insurance – for loss and damage to the works;
- plant insurance – for loss of equipment on site that is critical to the performance of the contract;
- public liability insurance – for legal liability to third parties; and
- professional indemnity insurance – for the design of the construction work.

However, often other insurances (eg, marine cargo insurance and motor vehicle insurance) are taken out where the specific project involves relevant risks.

7.4 Insolvency

Under most contracts in New Zealand, the insolvency of a party permits the other party to terminate the contract. The insolvency of the

contractor also permits the employer to resume possession of the site.

7.5 Risk Sharing

Risk-sharing arrangements are not common in New Zealand and are most often found in alliance agreements or target cost arrangements (see 4.1 Contract Price).

The orthodox approach regarding risk in New Zealand is to allocate the risk to the party who is best placed to control that risk. Alternatively, a party may accept additional risk for a price premium (if accepted by the contractor) or reduction (if accepted by the employer).

Pricing Shared Risks

Most New Zealand contracts allocate risks rather than share the risks. However, where risks are shared these are generally priced through a target price mechanism. The parties share in the cost overruns or savings (if the actual price is above or below the target) based on pre-set percentages or values. Risk sharing regimes can incentivise the contractor to carefully manage the applicable risk. There are many ways to structure such mechanisms and it is still common for specified risks to be allocated solely to a particular party.

Cost fluctuation clauses can allow the parties to share the risk of inflation (see 4.2 Indexation).

8. Contract Administration and Claims

8.1 Personnel

Employers frequently require the contractor to:

- retain key personnel – often any change to key personnel will require the employer's approval; and
- remove unsuitable personnel – in standard form contracts, the employer may require that contractors remove personnel for serious misconduct, incompetence, negligence, or causing danger to safety.

8.2 Subcontracting

NZS construction contracts prohibit a contractor from subcontracting the whole or substantially the whole works. Subcontracting generally requires the employer's consent. Subcontracting does not relieve the contractor from any liability or contractual obligations owed to the employer under the contract.

8.3 Intellectual Property

Typically, the employer and the contractor will each retain their IP rights but grant licences to the other to the extent necessary for the project. Rights over new IP that may result from the work under a contract are negotiated and vary significantly. One common approach is shared ownership of the new IP with cross-licences. Often parties agree to indemnities for infringement of third-party IP rights.

9. Remedies and Damages

9.1 Remedies

Contract law in New Zealand recognises general damages for breach of contract. Sufficiently serious breaches of contract may also entitle a party to terminate the contract.

Common Employer Remedies

Common employer remedies include:

- liquidated damages for delay (see 5.3 Remedies in the Event of Delays);
- rectification of defects or the right to recover the cost of rectifying defects by third parties (see 3.11 Defects and Defects Liability Period);
- damages for non-performance (see 7.2 Guarantees);
- the right to draw upon bonds, parent company guarantees, or retentions (see 7.2 Guarantees and 3.11 Defects and Defect Liability Period); and
- suspension or termination of the contract.

Common Contractor Remedies

Common contractor remedies include:

- payment, including interest when payment is late (see 4.3 Payment);
- variations (see 3.2 Variations);
- extensions of time (see 5.4 Extension of Time); and
- suspension or termination of the contract.

9.2 Restricting Remedies

For further details of restricting remedies, see 6.1 Exclusion of Liability, 6.3 Limitation of Liability, 9.3 Sole Remedy Clauses and 9.4 Excluded Damages.

In New Zealand, statutory limitations under the Limitation Act 2010 restrict how long after a contract or an event a party can bring a claim. Parties also often contractually limit the duration of liabilities. Liability under consultancy contracts, for example, is typically limited to six years from the date that the services were completed.

9.3 Sole Remedy Clauses

Sole remedy clauses are not included in standard NZS construction contracts but are enforceable in commercial contracts. Where a contract

provides for delay liquidated damages, this will typically be considered the sole remedy for delay.

9.4 Excluded Damages

Often commercial parties in New Zealand exclude liability for:

- indirect, consequential, special, incidental, exemplary or punitive loss or damage; and
- loss of profit, revenue and goodwill or loss of production.

9.5 Retention and Suspension Rights Retentions

Retentions are permitted and commonplace in New Zealand construction contracts. Employers automatically hold retention monies on trust for the contractor under the Construction Contracts Act. Further requirements, including holding retentions in a separate and compliant bank account in New Zealand and regularly reporting, came into force on 5 October 2023.

Suspension Rights

Contractors have statutory suspension rights for non-payment but, under NZS forms of contract, they usually may not suspend works in dispute.

9.6 Termination

The power to terminate a construction contract, and associated remedies, depend on the contract terms. Construction contracts in New Zealand usually permit termination for frustration and default, and the types of default enabling termination are often aligned with the obligations of each party.

Contractor Default

For contractors, grounds for termination include:

- an insolvency event;

- subletting the whole or the majority of the works to another entity without consent;
- material breach of contract; or
- persistently, flagrantly or wilfully neglecting to carry out its obligations under the contract.

Termination for contractor default ordinarily entitles the employer to expel the contractor from the site and to have the works completed by third parties, with additional costs being recoverable from the contractor.

Some construction contracts also permit the employer to terminate the contract at its convenience. Such clauses may entitle the contractor to payment for completed works, under-recovered costs, and an allowance for lost profit.

Employer Default

For employers, grounds for termination include:

- an insolvency event;
- abandoning the contract;
- material breach of contract; or
- persistently, flagrantly or wilfully neglecting to carry out its obligations under the contract.

Termination for employer default traditionally entitles the contractor to payment for completed works, under-recovered costs, and an allowance for lost profits.

Termination Prerequisites and Wrongful Termination

Most construction contracts in New Zealand require the terminating party to notify the defaulting party of the default and to provide an opportunity for the defaulting party to remedy the default within a contractually mandated period. If the default capable of remedy is not remedied, then the terminating party may proceed with termination.

New Zealand also recognises the concept of wrongful termination if a party purports to terminate the contract without a valid basis, or without following the contractually required process, which can result in damages.

10. Dispute Resolution

10.1 Regular Dispute Resolution Courts

In New Zealand, four tiers of court may hear construction disputes. In descending order, they are:

- the Supreme Court;
- the Court of Appeal;
- the High Court; and
- the District Court.

Adjudication

In New Zealand, parties may not contract out of the adjudication process, which is outlined in the Construction Contracts Act. Adjudication is a swift but interim dispute resolution process that occurs entirely through written submissions. There are no hearings.

Adjudication decisions are binding and any awards must be paid within two working days of award. Notwithstanding the obligation to pay, parties may then proceed to litigation or arbitration for final determination of the dispute. Adjudications are determined by a single adjudicator from a recognised institution.

Recognised Institutions

In New Zealand, there are several institutions recognised as competent to appoint persons to hear construction disputes as adjudicators or arbitrators. These include:

- the Building Disputes Tribunal;
- the New Zealand Dispute Resolution Centre; and
- the Arbitrators and Mediators Institute of New Zealand.

10.2 Alternative Dispute Resolution

The following private and alternative dispute resolution options are recognised in New Zealand.

- Arbitration – this binding form of dispute resolution is often used in New Zealand contracts and is included in NZS forms of contract. Arbitration has its statutory basis in the Arbitration Act 1996.
- Mediation – this non-binding form of dispute resolution is common in New Zealand contracts and is included in NZS forms of contract.
- Expert recommendation/determination – referrals to experts for either binding decisions or non-binding recommendations are frequent in New Zealand.
- Dispute review boards – these are often limited to major projects, due to the cost. The extent of their authority varies for each contract.

NORWAY

Law and Practice

Contributed by:

Jacob F Bull, Henrik Møinichen and Pernille Bergan Yang
Advokatfirmaet Thommessen AS



Contents

1. General p.454

- 1.1 Governing Law p.454
- 1.2 Standard Contracts p.454

2. Parties p.455

- 2.1 The Employer p.455
- 2.2 The Contractor p.456
- 2.3 The Subcontractors p.457
- 2.4 The Financiers p.457
- 2.5 The Designer p.457

3. Works p.458

- 3.1 Scope p.458
- 3.2 Variations p.458
- 3.3 Design p.459
- 3.4 Construction p.459
- 3.5 Site p.459
- 3.6 Permits p.460
- 3.7 Maintenance p.460
- 3.8 Other Functions p.460
- 3.9 Tests p.460
- 3.10 Completion, Takeover and Delivery p.461
- 3.11 Defects and Defects Liability Period p.461

4. Price p.462

- 4.1 Contract Price p.462
- 4.2 Indexation p.462
- 4.3 Payment p.462
- 4.4 Invoicing p.463

5. Time p.463

- 5.1 Planning and Programme p.463
- 5.2 Delays p.464
- 5.3 Remedies in the Event of Delays p.464
- 5.4 Extension of Time p.465
- 5.5 Force Majeure p.465
- 5.6 Unforeseen Circumstances p.466
- 5.7 Disruption p.466

6. Liability p.467

- 6.1 Exclusion of Liability p.467
- 6.2 Wilful Misconduct and Gross Negligence p.467
- 6.3 Limitation of Liability p.467

7. Risk, Insurance and Securities p.467

- 7.1 Indemnities p.467
- 7.2 Guarantees p.468
- 7.3 Insurance p.468
- 7.4 Insolvency p.469
- 7.5 Risk Sharing p.469

8. Contract Administration and Claims p.470

- 8.1 Personnel p.470
- 8.2 Subcontracting p.470
- 8.3 Intellectual Property p.470

9. Remedies and Damages p.471

- 9.1 Remedies p.471
- 9.2 Restricting Remedies p.471
- 9.3 Sole Remedy Clauses p.472
- 9.4 Excluded Damages p.472
- 9.5 Retention and Suspension Rights p.472
- 9.6 Termination p.473

10. Dispute Resolution p.473

- 10.1 Regular Dispute Resolution p.473
- 10.2 Alternative Dispute Resolution p.474

Advokatfirmaet Thommessen AS is one of Norway's leading commercial law firms, with offices in Oslo, Bergen, Stavanger and London. Since being founded in 1856, Thommessen has been closely involved in most of the defining developments in Norwegian business. The firm has 391 highly qualified employees, including 288 lawyers assisting businesses with transactions, complex projects and contentious matters in all areas of commercial law. Bring-

ing experience and innovation together, the firm is well placed to meet clients' need for timely and bold advice. Thommessen is an independent law firm and has established relations with highly regarded law firms all over the world. The firm places great emphasis on being a professional partner for its clients, and on providing independent advice of the highest professional and ethical standard.

Authors



Jacob F Bull is a partner of Thommessen and heads the firm's practice group for onshore and offshore construction. He has extensive experience with construction projects both in

Norway and abroad. Jacob provides advice in all phases of a project, both during the contract negotiation phase and during the execution phase. His name is often highlighted by international rating agencies. Jacob is also appointed as mediator or arbitrator in larger construction matters.



Henrik Møinichen is a partner of Thommessen and works within the firm's practice areas of dispute resolution, construction, shipping and insurance. Henrik has been actively involved in

several onshore and offshore construction projects, including assistance in preparing tender documents, negotiations and dispute resolution. Henrik has assisted Norwegian and international clients in major litigation before ordinary courts and arbitration proceedings. He is currently involved in shipping, insurance cover and construction disputes.



Pernille Bergan Yang is an associate at Thommessen and works within the firm's practice group for onshore and offshore construction. Pernille assists both Norwegian and

international clients in matters related to shipping, construction and renewable energy. Pernille has been involved in several development projects in the field of onshore and offshore construction, including assistance in preparing tender documents, negotiations and dispute resolution.

Advokatfirmaet Thommessen AS

Ruseløkkveien 38
0251
Oslo
Norway

Tel: +47 23 11 11 11
Email: firmapost@thommessen.no
Web: www.thommessen.no/en/

THOMMESSEN

1. General

1.1 Governing Law

Principal Laws Governing the Construction Market in Norway

The fundamental starting point is that the parties to construction contracts are free to agree on whatever terms they desire (principle of contractual freedom). Mandatory legislation is given in respect of (among others):

- consumer protection;
- HSE;
- minimum and mandatory technical requirements for buildings;
- environmental requirements;
- working conditions; and
- tax.

Between professional parties, contracts will generally be interpreted in light of (and, if the contract is silent on a particular issue, will be supplemented by) general principles of Norwegian contract and construction law. The Norwegian Sales of Goods Act, 1988 does, to a large extent, express general principles of Norwegian contract law. This act may be directly applicable as background law for certain design and build contracts, and may in any event be important for the interpretation of unclear terms and for

supplementing the contract if there is a disputed matter that has not been completely regulated.

Otherwise, the general principles of Norwegian contract and construction law have been developed over time by the courts (case law) and are discussed in Norwegian legal textbooks.

1.2 Standard Contracts

Standard contracts are used in most construction projects in Norway.

The two most used standard contracts for onshore construction work are:

- NS 8405:2008 – Norwegian building and civil engineering contracts; and
- NS 8407:2011 – general conditions of contract for design and build contracts.

These standards are 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. These standards may therefore be seen as “agreed documents”.

NS 8405 is intended to be used in contractual relationships where the contractor shall carry out building or civil engineering work (includ-

ing installations, new buildings, maintenance, repairs and alterations) for the employer, and where most of the drawings, descriptions and calculations are provided by the employer.

NS 8407 is intended to be used in contractual relationships where the contractor shall perform all or a substantial part of the design work in addition to the execution of building or civil engineering work (including installations, new buildings, maintenance, repairs and alterations) for the employer.

Other Norwegian standard contracts are also often used in connection with onshore construction projects:

- NS 8401:2010 – general conditions of contract for design commissions; and
- NS 8402:2010 – general conditions of contract for consultancy commissions with remuneration based on actual hours spent.

Within the offshore sector, the Norwegian Fabrication Contract NF 15 (fabrication/construction obligations on the contractor) and the Norwegian Total Contract NTK 15 (design and fabrication/construction obligations on the contractor) are commonly used. Certain employers also use these standards as a basis for their contracts for onshore construction projects.

2. Parties

2.1 The Employer

Companies That Act as Employers

The kinds of companies and/or institutions that act as employers in construction projects in Norway vary depending on location and type of project. The employer can be an individual (for example, a landowner) or can include both

larger and smaller companies and organisations. Common entities are various public agencies, industrial companies, municipalities and housing companies.

Employer's Rights and Obligations Under a Construction Contract

The rights and obligations of the employer naturally depend on the specific contract, including type and size of the contract in question. Nevertheless, the employer's main right is to receive the agreed works within the agreed milestones and final completion date free of defects.

As a starting point, the extent of the employer's obligations – and thereby also the risk division between the employer and the contractor – depends on whether the employer is to provide the substantial part of the design work (drawings, descriptions and calculations), or on whether the contractor shall perform all or a substantial part of the design work in addition to the construction work.

The general obligations of the employer under a standard construction contract normally include the following:

- to pay the agreed contract price (lump sum(s), unit prices and/or reimbursable items);
- to provide the design/engineering (if and to the extent allocated to the employer);
- to perform other deliverables (employer-provided items);
- to obtain necessary permits (at least those that must be provided by the employer);
- to provide the contractor with access to the site as agreed and/or as required;
- to respond to the inquiries raised by the contractor during the contract period;
- to co-ordinate with the employer's other contractors involved in the project;

- to issue variation orders and respond to variation order requests; and
- a general duty to act and co-operate loyally with the contractor.

Relations Between the Employer, Contractor, Subcontractor and the Financiers

Depending on the type of contract, the roles and distribution of responsibility between the employer and the contractor vary. The typical relationship between the employer and contractor is mainly transactional, but the parties generally need to co-operate to a certain extent. The standard contracts establish a system consisting of notice and claim obligations, which requires interaction between the parties.

Typically, the subcontractors enter into separate contracts with the contractor, often with corresponding rights and obligations as between the employer and the main contractor (back-to-back).

The financiers typically also enter into separate financing agreements with the relevant party financing the construction project (often the employer). In Norway, mainly wind farm projects have been project-financed, though project financing is also expected to be used in the development of other types of energy projects in the coming years.

2.2 The Contractor

Companies That Act as Contractors

The kinds of companies that act as contractors in construction projects in Norway vary depending on the type of project. Contractors are typically privately owned entities operating in Norway as such, or within a specific region.

Contractor's Rights and Obligations Under a Construction Contract

The rights and obligations of the contractor naturally depend on the specific contract, including type and size of the contract in question. Nevertheless, the contractor's main right is to receive the agreed contract price within the due date(s). Construction contracts also regularly entitle the contractor to additional time and/or additional payment for variations to the scope of work.

As a starting point, the extent of the contractor's obligations – and thereby also the risk division between the employer and the contractor – depends on whether the contractor shall perform all or a substantial part of the design work in addition to the construction work.

The general obligations of the contractor under a standard construction contract normally include the following.

- To perform and complete the contract works in accordance with the contractual requirements, official standards and industry norms by the agreed completion date.
- To remedy defective works or parts during the agreed warranty period (usually five years).
- To notify the employer of:
 - (a) errors or defaults in the employer's requirements;
 - (b) inconsistencies in the design documents;
 - (c) ground conditions; and
 - (d) in general, all parts of the employer's involvement.
- To provide insurance and security.

General Relations Between the Employer, Contractor, Subcontractor and the Financiers
See 2.1 The Employer.

2.3 The Subcontractors Companies That Act as Subcontractors

Companies that act as subcontractors are typically the same companies that act as main contractors. Subcontractors may also be companies with specialist knowledge in a specific area needed in the relevant project.

Subcontractor's Rights and Obligations Under a Construction Contract

The rights and obligations of the subcontractor may vary depending on the specific contract, including the contract's scope and size. Often, the general rights and obligations of the subcontractors are comparable with the rights and obligations of the contractor towards the employer. The subcontract may be entered into on a so-called back-to-back basis, which means that the subcontractor assumes the obligations of the contractor set out in the main contract.

General Relations Between the Employer, Contractor, Subcontractor and the Financiers See 2.1 The Employer.

2.4 The Financiers Companies That Act as Financiers

Construction projects in Norway are typically financed by private banks, pension funds and public entities.

Financier's Rights and Obligations Under a Construction Contract

In general, a financier is not a party to the construction contract that they are funding, and consequently they do not have any direct rights or obligations under the contract. Financiers enter into separate contracts with the relevant party to the contract establishing the financiers' rights and obligations.

General Relations Between the Employer, Contractor, Subcontractor and the Financiers See 2.1 The Employer.

2.5 The Designer Companies That Act as Designers

Various types of companies and institutions can act as designers in Norwegian construction projects. These may include:

- architectural firms;
- engineering firms;
- design consultancies; or
- specialised design companies.

Additionally, public institutions, such as municipalities or government agencies, may also act as designers.

Designer's Rights and Obligations Under a Construction Contract

The rights and obligations of the designer are typically outlined in the independent design contract itself. For independent design contracts, the use of NS 8401 or NS 8402 is common. See also 1.2 Standard Contracts.

In general, the designer is responsible for:

- creating and developing the design concept;
- preparing detailed drawings and specifications; and
- ensuring compliance with applicable regulations and standards.

The designer is generally also responsible for providing technical expertise and assisting in the construction process, as a consultant either to the employer or to the contractor.

General Relations Between the Designer, Employer and the Contractor

The relationship between the designer, employer and the contractor varies depending on the project and the underlying construction contract in use (NS 8405 or NS 8407); see also **1.2 Standard Contracts**.

Under NS 8405, the designer typically has a direct contractual relationship with the employer. The designer's role is to provide design services and to co-ordinate with the employer and the contractor throughout the project.

Under NS 8407, the designer is often engaged by the contractor as a subcontractor. The contractor is responsible for co-ordinating the design process and managing the relationship with the designer. The employer may still have some involvement in the design process, but the primary contractual relationship is between the contractor and the designer.

3. Works

3.1 Scope

As a starting point, the freedom of contract enables the parties to agree on the scope of work in each construction contract.

Usually, the employer issues either a public or private invitation to tender to the market/chosen tenderers, which may consist of functional requirements to be achieved or detailed specifications (or a combination). Negotiations may be held before the contract is concluded with a set scope.

After conclusion of the contract and throughout the contract period, the scope may be subject to

variations, including additional work, reduction of work (negative changes) and other changes.

3.2 Variations

As there is no mandatory law regulating professional construction contracts, the starting point will always be the parties' agreement. In general, the parties tend to adopt a standard contract that contains provisions regarding the employer's right to vary the works and the contractor's right to request variations, including both additional compensation and time extension.

Variations Imposed by the Employer

In accordance with NS 8405 and NS 8407, the employer is entitled to order variations to the scope of work. Variations shall, in principle, be notified through formal variation orders.

The employer's right is commonly limited in that the variation 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 typically not entitled to order variations representing an addition to the contract price of more than 15%.

Variations Requested by the Contractor

If variations are imposed on the contractor's work without the employer's use of formal variation orders (referred to as an instruction or irregular variation order), the contractor is nevertheless obliged to implement the variations.

If, in the contractor's opinion, an instruction represents changes to the agreed scope of work, the contractor must notify the employer without undue delay if it wishes to invoke this instruction as a variation to the work. This usually happens in the form of a variation order request, where the employer again must respond to the request

by issuing a formal variation order or must reject the request. Similarly, if circumstances for which the employer carries the risk have occurred and affect the contractor's performance, the contractor must notify the employer without undue delay in order to be entitled to additional compensation and/or time extension.

Both the contractor and the employer should be aware that the Norwegian standard contracts include deadlines that both parties must comply with in respect of variations, typically to notify or respond without undue delay. If any such deadline is not complied with, the contractor may lose its right to claim additional compensation or time extension, and the employer may lose its right to contest that there is a variation to the work or to contest the alleged consequences thereof.

Additional Compensation – Time-Related Costs

For the performance of variation work, the contractor is entitled to additional time and/or payment for the given variations. The price for the variation work can firstly be agreed on a lump sum basis between the parties. In the absence of an agreement, the contract's unit rates shall apply, if applicable. The variation work will, however, often be performed on a reimbursable basis after the contractor has given a price estimate for the works. The principles for determining the price for the variation work are equal regardless of whether the variations are imposed by the employer or requested by the contractor.

As for time-related costs, also referred to as prolongation costs (increased costs of all kinds due to an extension of the contract period), the basic principle is that the contractor is also entitled to compensation for all such additional costs to the extent that the contractor is able to substantiate that they are caused by circumstances for

which the employer carries the risk. This typically concerns so-called preliminary costs (costs for running and managing the project).

Occasionally, and particularly in larger projects, the parties will agree on a formula for calculating the time-related costs that the contractor is automatically entitled to if the contract period is extended.

3.3 Design

The responsibilities regarding the design process between the employer, the designer, the contractor and other parties will vary depending on the parties' agreement. The responsibility can be clearly divided, but can also be apportioned between the relevant parties.

The choice between the two most common Norwegian standard contracts (NS 8405 and NS 8407) is made based on which party is responsible for providing the majority of the design work. For independent design contracts, the use of NS 8401 or NS 8402 is common.

See also **1.2 Standard Contracts**.

3.4 Construction

The responsibilities regarding the construction process may be agreed on according to the wishes of the parties. In general, the contractor performs the construction work (often using subcontractors) while the employer provides information, permits, approvals and typically holds more controlling functions.

See **2.1 The Employer** and **2.2 The Contractor**.

3.5 Site

The tender documents issued by the employer will often include information about the construction site, including pollution, underground

obstacles, geotechnical conditions, archaeological finds, etc.

In the absence of other agreements, the starting point is that the employer carries the risk for ground conditions if they deviate from what the contractor had reason to expect when preparing its tender. In this regard, it is provided that the contractor shall undertake a careful inspection of the construction area and its surroundings, and shall obtain available information about the ground conditions, including information about cables, pipes, etc. The employer is, however, obliged to provide all known information about the conditions which it would assume would be of interest to the contractor. In general, all provided and incorrect information is at the employer's risk.

3.6 Permits

Permits and Licences

Construction work of a certain magnitude requires specific permissions from the relevant building authorities before the work can be started. In addition, those performing construction work need general permits for their respective activities and for the specific work to be undertaken. A construction project can also trigger the need for obtaining other permits, including permits concerning pollution and construction waste.

The Norwegian Planning and Building Act 2008, and all subordinate legislation pursuant thereto, contains building regulations that apply to construction work in Norway.

The party responsible for obtaining the permits is typically the architect, another designer or the project manager. The parties can otherwise agree on which party will be responsible. In the

absence of any agreements, site-related permits would typically be at the employer's risk.

3.7 Maintenance

The Norwegian standard contracts do not include maintenance after completion (takeover) of the project. Accordingly, as this is not generally included as part of the contractor's scope of work, the employer is typically responsible for the maintenance of the works. However, up until completion of the project (takeover), it is a part of the contractor's scope of work to ensure that the contract works are "maintained" in the sense that they meet the contractual requirements.

Within certain areas, such as wind farm projects, it is rather common for the employer and the contractor to enter into an operation and maintenance agreement. Such agreement normally includes an availability guarantee, and the contractor is responsible both for scheduled and for unscheduled maintenance.

Also, in certain infrastructure projects such as road construction projects, the contract may include maintenance obligations on the contractor for an agreed duration after takeover.

3.8 Other Functions

Other functions in the construction process, such as operation, finance and transfer, are generally not instructed by the employer to the contractor or third parties. Exceptions do occur in certain types of projects.

3.9 Tests

A construction contract is often based on takeover taking place in several stages where technical facilities form part of the contract work. The contractor shall carry out inspections, testing and adjustments, etc, of the work, after which the takeover process itself can be carried out.

The contractor is responsible for the necessary testing being carried out, but the employer shall contribute to the extent necessary to ensure accomplishment. Tests must be carried out until the system functions satisfactorily. The contractor must document the implementation and results of the tests.

In larger projects, it is common for the parties to agree in further detail on how and when all required tests and commissioning activities shall be carried out, before takeover can take place.

3.10 Completion, Takeover and Delivery The Process of Completion, Takeover and Delivery

The Norwegian standard contracts stipulate provisions regarding the completion, takeover and delivery of works.

The contractor (or subcontractor) shall, in a reasonable time before the contract work is completed (usually two weeks), summon the employer (or main contractor) in writing to proceedings for taking over the works. In this regard, the contractor shall deliver all necessary documentation regarding the works in advance.

A record must be kept of the proceedings, stating:

- who is present;
- deficiencies that are identified;
- the deadline for rectification of proven deficiencies and time needed for any post-inspection;
- whether the contract work is taken over or was refused to be taken over; and
- the employer's reasons for refusing to take over, and the contractor's reasons if the contractor does not accept this.

The record must be signed by both parties.

Legal Consequences of Takeover

The legal consequences of takeover are well regulated in the standard contracts and can also be agreed by the parties. Common legal consequences are as follows:

- the employer becomes entitled to start using the contract work;
- the risk of loss of or damage to the contract work passes from the contractor to the employer;
- any delay liquidated damages cease to accrue;
- the contractor's obligation to keep the contract work insured ceases;
- security that the contractor has provided in respect of liability during the execution period is reduced in accordance with agreed provisions;
- the contractor must issue a final account proposal and the final invoice to the employer; and
- the defect notification period (warranty period) commences.

3.11 Defects and Defects Liability Period

In accordance with NS 8405 and NS 8407, the defects liability period for defects (warranty period) is five years after taking over. In order to invoke any remedies for defects, the employer also needs to notify within a reasonable time period after it has or ought to have discovered the defect.

Usually, for the parts of the contract work that have been remedied, a new five-year period shall run from completion of the remediation work for the part in question. The new period must not exceed the original deadline by more than one year. Irrespective of the five-year period for noti-

fication, the employer shall be entitled to invoke defects that the contractor has caused intentionally or through gross negligence.

The authors note that, due to short statutory limitation periods under Norwegian law (usually three years), claims may become time-barred even before the expiry of the warranty period. Therefore, the employer may have to ensure that statutory limitation periods are complied with in parallel, which may require commencing legal proceedings or obtaining an extension of time-bars.

Remedies

In the case of defects, the remedies available to the employer are (usually) set out in the contract. As per NS 8405 and NS 8407, the contractor shall be obliged to remedy a defect and be liable for costs of remedying damage caused by the defect, unless the costs of remediation will be disproportionate to the result achieved. Secondary legal remedies include price reduction and compensation for damages, and the last resort is termination of the contract.

4. Price

4.1 Contract Price

The contract price can be a fixed price (lump sum), unit prices, reimbursable items or (as is often the case) a combination of these. The parties may also agree on a target price that is a jointly determined final cost, including incentives for achievement for both parties.

The price generally includes all contract work, including materials necessary for the contractor's completion. The establishment of the contract price is usually based on the employer's

invitation to tender and the contractor's tender under which the contractor will offer a price.

Milestone payments are commonly agreed on, together with several other types of payment methods such as monthly payments, advanced payments, etc. See also 4.3 Payment.

4.2 Indexation

Indexation of prices is commonly used in construction contracts in Norway to address the risk of price fluctuations. The specific allocation of risk for large price fluctuations between parties can vary depending on the specific contract regulation. The risk may be allocated to one party (for example, through fixed price contracts) or shared through an agreed price adjustment clause.

Both NS 8405 and NS 8407 contain price adjustment clauses, stating that all price elements shall be index-linked unless otherwise agreed. Such index-linking takes place in accordance with an agreed total index method.

4.3 Payment

Late or No Payment

In the events of late payment, the contractor is entitled to interest on overdue payments according to the Norwegian Act 1976 Relating to Interest on Overdue Payments. The interest rate is determined every six months and will usually be somewhere between 8% and 11% per annum.

In accordance with NS 8405 and NS 8407, the contractor may, in addition to claiming interest, suspend the execution of the works in the event of a material breach of the employer's payment obligation, or where it is clear that such breach will occur. In such case, the contractor must issue a written notice in advance, giving the employer 24 hours to pay. In the event of (a

legitimate) suspension, the contractor is entitled to claim additional time and additional payment.

Advanced Payments, Interim Payments and Delayed Payments

The parties are free to agree on a payment period as well as on the method of payment.

Advance payments are common in construction projects. In such cases, the employer would usually require security by way of a bank guarantee, either by a general guarantee covering the contractor's performance of its obligations under the contract or by a specific advance payment guarantee. As a starting point, unless otherwise agreed, the Norwegian standard contracts provide that the contractor shall provide security amounting to 10% of the contract price.

In addition, the employer is entitled to deduct from the contractor's invoices a certain percentage of the invoiced amount in retention monies. The contractor cannot invoice this amount before the final invoice is issued.

The contract also holds other security mechanisms, such as the employer's right to withhold payment in order to secure its claims following the contractor's breach of contract. See also **7.2 Guarantees**.

Interim payments, in the sense that a contractor receives the contract price in stages, are very common. These are usually regulated by making payments of defined parts of the purchase price upon achieving predefined payment milestones. Also, ordinary progress payments as the project goes forward are common if the contract work is (mainly) compensated on a reimbursable basis or is based on unit prices/rates.

4.4 Invoicing

In accordance with NS 8405 and NS 8407, invoices must be paid by the employer within 28 days after receiving the invoice. The parties may otherwise agree on the length of the payment term.

In all cases, the invoices must be submitted as agreed in the contract, which may be through a digital platform, and the receiving party must be able to verify the works and the amount invoiced.

5. Time

5.1 Planning and Programme

The parties usually agree on a main contract schedule that forms part of the contract. The contract schedule may include milestones for the fulfilment of both parties' obligations.

In general, the contractor must document that the milestones have been achieved.

As per NS 8405 and NS 8407, unless otherwise agreed, the contractor must submit a contract schedule within four to six weeks after the contract is entered into. This schedule must, as a minimum, include the main activities to be carried out by the contractor and other activities which the contractor may be dependent on, including works to be performed by the employer's other contractors. Further, the contractor is, on a running basis, obliged to inform the employer of the actual progress of the works, and to notify the employer of any (significant) deviations from the schedule. In the case of significant deviations, the contractor must present a revised schedule.

In larger construction projects, the parties often agree on rather detailed administrative requirements, which will include the contractor's plan-

ning and reporting. Often, a set of different schedules on different levels (contract baseline schedules, etc) may be agreed on.

The parties are free to agree on milestone dates, including milestone dates subject to liquidated damages, in the case of delay. Provisions regarding liquidated damages in the case of delay are set out in all standard contracts. In general, the contract completion date is sanctioned by delay liquidated damages. In other cases, the parties must agree that a milestone shall be subject to liquidated damages. An actual loss is not required to claim payment of such liquidated damages.

5.2 Delays

Both parties have an obligation to notify the other party of a delay.

A delay may entitle the contractor to an extension of time and, in some cases, to additional payment, if the progress is impacted due to circumstances for which the employer carries the risk. Correspondingly, the employer may also be entitled to an extension of time if the employer is hindered in its contribution by circumstances for which the contractor carries the risk.

If a party wishes to demand extension of time due to delay, such party shall notify the other party without undue delay, and must do so in order to safeguard its claim for extension of time.

In the case of concurrent delay, the contractor would, as a general rule, only be entitled to an extension of time for the parts of the delay that can be attributed to events for which the employer carries the risk, provided that such events have an impact on the contract's "critical path". If the contractor's delay results from two parallel delays, under which the contractor itself

is equally liable, the contractor would, as a general rule, not be entitled to an extension of time.

As for the costs incurred by the contractor, the employer would only be liable for increased costs attributable to the parts of the delay for which the employer carries the risk. If the costs would have occurred regardless of the events for which the employer carries the risk, the contractor would, as a general rule, not be entitled to the costs occasioned by that concurrent delay.

In the case of delays, the contractor's claim for additional payment may generally include increased time-related costs (prolongation costs), as further explained in 3.2 Variations.

5.3 Remedies in the Event of Delays

If there is no basis for an extension of time nor other defences available for the contractor, the delay represents a breach of contract, where the employer normally has several remedies available, including:

- liquidated damages for delay;
- claim for damages; and
- termination.

The parties are free to agree on milestone dates, including milestones subject to liquidated damages in the case of delay. Provisions regarding liquidated damages in the case of delay are set out in all standard contracts. In both NS 8405 and NS 8407, the rate is set at 0.1% of the total contract price per day, and the total sum of attainable liquidated damages is capped at 10% of the total contract price, unless the delay is caused by the contractor's gross negligence or wilful misconduct.

Liquidated damages will correspond to a pre-agreed standard sum payable to the employer.

Liquidated damages will therefore be claimable regardless of any negligence on the part of the contractor and regardless of whether the employer has suffered any loss due to the delay.

As an alternative to liquidated damages, in cases where the delay is caused by gross negligence or wilful misconduct of the contractor or someone for whom contractor is responsible, the employer may instead claim compensation for the losses suffered due to the delay.

The employer may also terminate the contract in the case of a substantial breach of contract on the part of the contractor, including for significant delays or if it is evident that such significant delays will occur.

5.4 Extension of Time

In accordance with NS 8405 and NS 8407, the contractor is entitled to an extension of time if the execution of the works is delayed due to the following circumstances:

- variations;
- delays or defects in the employer's performance of its contractual obligations; and
- other circumstances for which the employer carries the risk under the contract.

Claims for extension of time are made in a written notice to the employer (often by a pre-agreed and standardised form), stating the reason and required extension.

The extension of time should, in principle, correspond to the effect of the impediment. Both NS 8405 and NS 8407 contain a separate clause specifying how the extension should be calculated and which factors should be considered, such as necessary stoppages and any postponement of execution to a time of year that is

more or less favourable to the party concerned. Ultimately, the calculation of the extension often depends on an assessment of evidence. The starting point is that the party requesting extension of time must prove, on the balance of probabilities, both the basis for the extension and the extent of the extension.

5.5 Force Majeure

Norwegian law recognises force majeure both as a statutory provision and as a contract term concerning relief from contractual obligations. A rule of force majeure also exists as a general principle of Norwegian contract law, and this is regulated in the Norwegian Sale of Goods Act, 1988. This means that a force majeure clause would usually not be needed for either party to claim an event as force majeure.

However, it is still common for the parties to expressly regulate force majeure. The individual contract provisions would nevertheless usually be interpreted in light of the general principles.

The parties are, as part of the freedom of contract, free to limit or exclude certain circumstances from being qualified as force majeure. It is not unusual for the contract to define force majeure as specific occurrences, to prevent subsequent interpretation disputes. According to NS 8405 and NS 8407, circumstances generally constituting force majeure include:

- extraordinary weather conditions;
- public orders and prohibitions; and
- strikes and lockouts.

The conditions for an event to be constituted as force majeure are assumed to be the same in accordance with the general principles of Norwegian contract law and the standard contracts.

The following four conditions must generally be fulfilled:

- an event that prevents the fulfilment of a contractual obligation has occurred;
- such event is considered to be beyond the control of the affected party;
- the affected party could not reasonably have foreseen the event when entering into the contract; and
- the affected party could not reasonably have avoided or overcome the event or its consequences.

In the case of force majeure, neither party shall be considered in breach of the contract, and each party will cover its own cost. This makes force majeure regulation reciprocal.

The affected party may be entitled to an extension of time, meaning that, if the affected party is prevented from performing its obligations in full, the contract is suspended until the party is (or should have been) able to resume the fulfilment. Fulfilment is suspended without financial responsibility for the party affected.

In any case, the parties must give notice to the other party if a force majeure event occurs.

5.6 Unforeseen Circumstances

Unforeseen circumstances are not governed by mandatory or regulatory law, but may be contractually agreed upon by the parties. Unforeseen circumstances may, however, qualify as a force majeure event if the conditions stated in 5.5 Force Majeure are met.

In exceptional cases that make it “highly unreasonable” for a party to perform as per the contract, unforeseen circumstances may also entitle such party to claim revision of contractual terms.

5.7 Disruption

Disruption or Inefficiency

Disruption or inefficiency is a known concept under Norwegian law, and briefly means that the contractor is faced with (significant) changes or disturbances that prevent them from performing the contract works as expected or as planned, and which thereby reduce productivity.

The required standard of proof – including what kinds of evidence the contractor generally must submit to be entitled to additional compensation due to inefficiency – has been discussed and clarified in recent Norwegian case law. The fundamental precedent is a Supreme Court judgment from 2019 (HR-2019-1225-A), which is often referred to as the “HAB judgment”.

The starting point is that disruption or inefficiency caused by circumstances for which the employer carries the risk may entitle the contractor to additional compensation. Thus, it is acknowledged that the contractor may incur additional costs as a result of inefficiency due to (significant) changes and/or (significant) disruptions during the execution phase. It follows directly from NS 8405 and NS 8407 that “reduced productivity” may entitle the contractor to additional compensation.

As per the Supreme Court’s guidelines, the contractor must prove, on the balance of probabilities, that all conditions for such disruption claims are fulfilled. A “global cover-all claim” is in principle not accepted. The individual events that form the underlying basis for such claims must be particularised. General experience and calculations may be a factor to consider, but such generic evidence only is not sufficient to prove inefficiency in respect of a specific project. Accordingly, project-specific evidence which

stems from the execution phase will be required to document such claims.

According to the Supreme Court's guidelines, the contractor must substantiate the alleged circumstances for which the employer carries the risk. This includes substantiating what work operations the relevant circumstances have affected and during which periods of time, and the consequences these circumstances have had for the contractor's productivity. In addition, the contractor must also substantiate, on the balance of probabilities, that these consequences actually resulted in the alleged disruption-related costs.

It would not be correct to say that disruption as such may entitle the contractor to an extension of time. However, when determining the schedule impact of an alleged variation or event, it follows from NS 8405 and NS 8407 that the overall effect of previous variations/events which have been notified by the contractor, and which could have entitled the contractor to an extension of time, shall be taken into account. As such, it is recognised that a significant number of variations may eventually have a schedule impact that the contractor should be able to invoke.

6. Liability

6.1 Exclusion of Liability

In Norway, certain liabilities cannot be limited, as follows:

- criminal liability;
- liabilities based on certain international conventions that cannot be derogated from; and
- liabilities that go beyond the purpose and intended scope of the contract.

Further, any limitation or waiver of liability will generally not be upheld in the event of wilful misconduct or gross negligence by a company's senior managerial personnel. See also **6.2 Wilful Misconduct and Gross Negligence**.

6.2 Wilful Misconduct and Gross Negligence

Wilful misconduct and gross negligence are known legal terms in Norway in several areas of law, including construction law. The concepts are often used to increase liability, and form common exceptions to agreed limitations of liability in construction contracts.

6.3 Limitation of Liability

In Norway, the "freedom of contract" principle entails a right for the parties to limit or exclude liability under the contract to some extent. This may include:

- capped amounts;
- liability for indirect or consequential losses; and
- the total liability for breach of contract and third-party losses.

Such limitations will generally be upheld by Norwegian courts and tribunals, unless the loss has been caused by wilful misconduct or gross negligence by a party's senior managerial personnel.

7. Risk, Insurance and Securities

7.1 Indemnities

Contractual indemnification provisions are quite common within certain industries. However, the standard construction contracts (NS 8405 and NS 8407) do not include any express indemnifications. As these standards, via other provisions, place and regulate responsibilities and

risks between the parties, specific indemnity clauses would not always be considered necessary.

However, the parties are free to agree on indemnification clauses. As an example, knock-for-knock terms and other reciprocal indemnity regimes are very common within the offshore industry.

7.2 Guarantees

General

Bank guarantees are the standard security in most Norwegian construction contracts.

Guarantees Provided by the Contractor

It is common for the contractor to be required to provide the employer with a performance security, to guarantee contractual performance. In general, there are no restrictions on the nature of such guarantee, given that the contract is entered into between professional parties.

According to the Norwegian standard contracts (NS 8405 and NS 8407), unless otherwise agreed, the contractor must provide security to the employer for the performance of its contractual obligations. This includes all potential liabilities that may arise during the execution phase and the contractor's liability for defects during the defect liability period (warranty period).

The security must be provided in the form of an ordinary guarantee from a bank (most common), insurance company or other financial institution. In larger construction projects, the requirement for on-demand guarantees has become quite common – ie, the guarantor cannot invoke any defences and/or counterclaims which otherwise would have been available to the contractor.

Also, in accordance with NS 8405 and NS 8407, the security shall amount to 10% of the contract price. Upon takeover of the work, the security shall be reduced to 3% of the contract price with reference to any guarantee claims for a period of three years.

It is also worth mentioning that employers may, on occasion, require a parent company guarantee if the contractor is a subsidiary of another company. There are no restrictions on the nature of a parent company guarantee, provided that the contract is entered into between professional parties.

Guarantees Provided by the Employer

In accordance with NS 8405 and NS 8407, unless otherwise agreed, the employer must also provide security for its performance under the contract amounting to 15% or 17.5% of the contract price. It is rather common to agree that (financially strong) employers need not provide such security, and the standard contracts expressly state that publicly owned employers are not obliged to provide such security.

7.3 Insurance

As a starting point, the parties are free to agree on an insurance regime, although some insurances are compulsory by law. The Norwegian standard contracts, however, set out an insurance regime typically used in construction contracts.

Contractor's Insurance

In accordance with NS 8405 and NS 8407, the contractor must keep materials and other parts of the work to be performed by the contractor insured until takeover of the contract object/ the contract works. The employer should be co-insured. The contractor must also maintain a liability insurance, covering any damage and

economic loss caused by the contractor to personnel or property of the employer or any third party.

Employer's Insurance

In connection with larger construction projects, the employer often provides and maintains a "Construction All Risk" (CAR) or "Builder's All Risk" (BAR) insurance where the contractor will be co-insured.

In other projects where the contractor provides the insurance, the employer must still, according to mandatory labour legislation, provide and maintain workmen's injury insurance for its personnel. Moreover, employers will always require the contractor to provide and maintain liability insurance; and, in the case of design work, the employer may typically require that professional liability insurance be provided and maintained by the engineer.

7.4 Insolvency

As a starting point, the parties may agree on contractual provisions regarding the consequences of insolvency of a party to the contract.

According to most Norwegian standard contracts, including NS 8405 and NS 8407, both parties are given a right to terminate the contract if the other party goes bankrupt or becomes insolvent. The employer shall, however, not be entitled to terminate the contract if it is proven without undue delay that the contract works will be completed in accordance with the contract, or if satisfactory security is provided without undue delay for timely performance.

That said, the parties to construction contracts that include such clauses should take into account the bankruptcy estate's right to enter into the debtor's agreements in accord-

ance with the Norwegian Creditors Security Act, 1984, which will prevail over agreed terms to the contrary. The bankruptcy estate will, however, usually be reluctant to step into a construction agreement and be obliged to fulfil the debtor's obligations.

7.5 Risk Sharing

The sharing of responsibility for certain risks is not common practice in Norway. Usually, the party to whom a risk shall be attributed is regulated in the contract, and would, if not directly regulated, be considered in light of whether the risk is connected to functions carried out by the employer or by the contractor – ie, the risk division follows the division of the parties' functions.

However, occasionally, certain mechanisms which are based on a "risk-sharing philosophy" are agreed. One such mechanism is referred to as partnering or partnering agreements. There are currently no general standards for partnering agreements in Norway. The purpose would be to ensure early interaction and co-operation with regard to developing the design (phase I), and to then agree on a target price mechanism for the remaining works (phase II). The parties may, as an example, share the "bonus" if the final cost is less than the target price (ie, a part of this "bonus" is paid to the contractor). Conversely, they will also share the risk of cost overruns, as the part of the total cost which exceeds the target price will not be compensated in full by the employer.

In reality, a more standard and simple target price mechanism that is intended to incentivise the contractor to reduce the project costs, without detailed partnering terms, is often more common.

Except for a target price mechanism, there are no typical concepts for “pricing shared risks” in construction projects that are subject to Norwegian standard contracts. As mentioned, risks would generally not be “shared”, but allocated to one of the parties. Target price mechanisms and bonus schemes may, however, be agreed on.

8. Contract Administration and Claims

8.1 Personnel

In all construction projects, and as provided for in NS 8405 and NS 8407, the employer and the contractor must appoint one representative with authority to act on each party’s behalf in all matters concerning the contract. The parties’ representative will therefore, as a starting point, be entitled to represent and decide on all matters with binding effect for the respective party.

In larger construction projects, it is common to include more detailed terms regarding the parties’ representatives and other individuals considered as “key personnel”. Typically, the contractor will not be entitled to appoint or replace its representative and key personnel without the employer’s prior consent, which may not be unreasonably withheld or delayed.

8.2 Subcontracting

Both NS 8405 and NS 8407 enable the contractor to use subcontractors.

When the contractor has chosen a subcontractor, it must notify the employer thereof and regarding which parts of the work will be carried out by the relevant subcontractor.

Certain conditions must be met by the subcontractors, and the employer may reject a chosen

subcontractor on a justifiable basis. In such case, the employer must notify the contractor of the rejection without undue delay and no later than 14 days after having received the requested information about the relevant subcontractor (eg, financial strength and technical competence).

In tender proceedings, the employer will often demand that the bidders name all their key subcontractors in the tender. The employer may also limit the number of subcontractors to be used. This typically results in a list of pre-agreed subcontractors to be used in the project.

8.3 Intellectual Property

Contractual provisions regarding intellectual property rights are only found to a limited extent in the Norwegian standard construction contracts (NS 8405 and NS 8407). 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.

Contractual provisions regarding intellectual property are also found in NS 8401 and NS 8402, which are used between commissioning parties, architects, consultant engineers and other professionals regarding design commissions; see **1.2 Standard Contracts**. The main rule is that the commissioning party shall be entitled to use materials prepared by the consultant for the completion of the project to which the commission is linked. If the commissioning party has

made payment for models and demonstration objects, these shall then become the property of the commissioning party. However, the consultant shall retain all other rights to its ideas and the materials it has prepared.

The authors note that, in standard contracts used within the offshore sector, there would typically be more detailed and somewhat different intellectual property terms. Typically, more rights are transferred to the employer than would otherwise follow from background law, such as in respect of inventions developed on the basis of information mainly provided by the employer.

9. Remedies and Damages

9.1 Remedies

General

A prerequisite for both parties to invoke legal remedies is often the fulfilment of the duty to notify either without undue delay or within fixed deadlines in connection with the final account. A failure to notify in time will usually imply that the party loses the right to pursue its claim.

The remedies available in the event of a breach of contract depend largely on the severity of the breach. Typical breaches of contract are related to delay and defects; and in the case of delay and defects, as well as late payment, the standard contracts typically provide the available remedies.

The consequences of any other breaches are to a lesser degree (directly) regulated in the standard contracts. As a starting point, unless otherwise stated, a party may hold the other party liable for damages for any losses suffered due to the other party's (negligent) breach of contract.

Employer's Remedies

In the case of delay, the main remedy available to the employer is liquidated damages; see **5.3 Remedies in the Event of Delays**. In the case of defects, the main remedy available to the employer is rectification work; see **3.11 Defects and Defects Liability Period**.

In the case of breaches unrelated to delays and defects, the employer may (as a starting point) hold the contractor liable for damages, and, if the breach is substantial, may terminate the contract.

Contractor's Remedies

If the employer is late in making payments, the contractor is entitled to claim interest on overdue payment (default interest). If the breach is material, the contractor may also be entitled to suspend the works; see **4.3 Payment**.

If the employer's breach of contract during the execution phase affects the contractor's work, the contractor may then be entitled to additional compensation and extension of time.

In the case of any other breaches by the employer, the contractor may (as a starting point) hold the employer liable for damages, and, if the breach is substantial, may terminate the contract.

9.2 Restricting Remedies

Limitations of Liability

It is common practice to contractually limit the remedies available to a party. In accordance with NS 8405 and NS 8407, the remedies available to the employer in the case of delays and defects are limited, as the standard contracts enumerate the remedies the employer may invoke and state that the right to claim damages (for losses that extend beyond the defined remedies) would only

be available to the employer in the case of wilful misconduct or gross negligence.

In line with the principle of freedom of contract, Norwegian courts and tribunals will generally uphold any limitations of liability that the parties have agreed on. Limitations may generally only be set aside in the case of wilful misconduct or gross negligence, as also stated in the standard contracts.

9.3 Sole Remedy Clauses

Contractual sole remedy clauses are known in construction contracts in Norway, particularly in standard contracts used within the offshore sector. As for NS 8405 and NS 8407, the “sole remedy effect” has been ensured in respect of the contractor’s delays and defects, by providing the remedies that are available to the employer and by stating that the employer may only claim compensation for any (other) losses in the case of wilful conduct or gross negligence.

As a clear general rule, sole remedy clauses will be upheld by Norwegian courts and tribunals. The general view is that they may only be set aside if a party suffers a loss which is caused by wilful misconduct or gross negligence on the part of the other party’s senior managerial personnel.

9.4 Excluded Damages

Losses that in most jurisdictions would be characterised as indirect or consequential are typically excluded from liability in construction contracts. The standards used within the offshore sector typically include reciprocal indemnities in respect of each party’s consequential losses.

NS 8405 and NS 8407 do not include a general or reciprocal indemnity or limitation of liability in respect of the parties’ indirect or consequential

losses. Further, the NS standards do not include a total liability cap limiting the contractor’s total liability. However, by providing an (exhaustive) list of the remedies that are available to the employer in the case of the contractor’s delays and defects, mainly covering necessary and direct costs and losses, the employer would in such cases not be entitled to hold the contractor liable for the employer’s indirect or consequential losses (except for cases of wilful misconduct and gross negligence).

9.5 Retention and Suspension Rights

Retention and suspension rights are generally not contractually excluded. Retention is usually regulated in the contract, whereas suspension is not necessarily regulated in the contract.

Retention

The right to retain part of the contract price is regulated in both NS 8405 and NS 8407. As an example, NS 8407 provides that a deduction of 7.5% of the progress payment shall be made by way of retention. The retention will be invoiced and payable as part of the final account. Further, the employer may withhold payments if the employer has a legitimate claim against the contractor.

Suspension

NS 8405 and NS 8407 do not include any provisions that entitle the employer to suspend the contractor’s performance of the work. Suspension would also not be available to the employer in accordance with general principles of Norwegian construction law, if this has not been expressly agreed on. Therefore, employers should consider the need for including a suspension clause.

Depending on the terms, the employer may in some cases use the variation order regime

to adjust the contract schedule, and this may potentially allow for deferring certain contract works. The standard variation order regime in NS 8405 and NS 8407 does not necessarily allow for this.

The authors note that the Norwegian offshore standards include a suspension clause that entitles the employer to suspend the contractor's performance of the work (or a part of the work), following which the contractor is entitled to additional payment and extension of time. If the work has not been resumed within 120 days, the contractor may cancel the contract for the affected part of the work and may claim compensation as per the termination for convenience (cancellation) terms.

9.6 Termination

The Right to Terminate a Construction Contract

As a general principle of Norwegian contract law, a party is entitled to terminate the contract (for cause) if the other party has substantially breached its contractual obligations. The same applies if it is evident that such substantial breach will occur. NS 8405 and NS 8407 are in line with this. What constitutes a substantial breach depends on a concrete assessment of the circumstances.

Another ground for termination is if a party goes bankrupt or becomes insolvent. See 7.4 **Insolvency**.

In accordance with NS 8405 and NS 8407, the employer is generally entitled to terminate the contract at its convenience. However, upon such termination, the contractor will be entitled to compensation for the loss the contractor has suffered as a consequence of the termination.

Contractual Consequences of Termination

In accordance with background law (and NS 8405 and NS 8407), the termination (for cause) of the contract results in the release of both parties from future obligations under the contract. Additionally, the aggrieved party is entitled to compensation equal to the financial losses incurred as a result of the other party's breach and the subsequent termination.

As per NS 8405 and NS 8407, the contractor shall be entitled to compensation for the work that has been completed at the time of termination. If the employer has (rightfully) terminated the contract, the employer shall be entitled to compensation for necessary additional costs incurred and for any foreseeable losses suffered due to the termination.

If the contractor has (rightfully) terminated the contract, the contractor shall be entitled to compensation for necessary additional costs incurred (including rigging-down and winding-up costs) due to the contract being terminated, as well as to compensation for lost profits in respect of such part of the work as will not be performed by the contractor due to the termination. The contractor may also claim compensation for foreseeable losses suffered due to the termination.

10. Dispute Resolution

10.1 Regular Dispute Resolution

In general, any dispute between the parties concerning the contractual relationship shall be settled by ordinary court proceedings unless it has been agreed that the dispute is to be settled by arbitration. Unless otherwise agreed, the judicial district of the building or civil engineering works

shall be the legal venue for all legal proceedings that may arise from the contract.

10.2 Alternative Dispute Resolution

Negotiations and Project-Integrated Mediation

Disputes concerning the contractual relationship should be attempted to be resolved amicably between the parties. This has also been expressed directly in NS 8405 and NS 8407.

If the parties agree, the standards also suggest that a meditation panel may be appointed (preferably at an early stage) to assist the parties in resolving any disputes that arise during the contract period. This is referred to as “project-integrated meditation” (PRIME). The panel will typically consist of three members that have been appointed jointly by the parties. The panel’s decisions will not be binding unless the parties have agreed that the decisions shall be binding.

Temporary Dispute Resolution by an Umpire

Both NS 8405 and NS 8407 stipulate that each of the parties can demand an umpire decision (*oppmannsavgjørelse*) on disputes, unless the dispute has already been brought before ordinary courts or arbitration. When the umpire has reached its decision, the parties must, within one month, notify each other in writing regarding whether or not they intend to accept the decision as binding.

Mediation

Norwegian courts offer a voluntary court-administered mediation, which may be held after the writ of summons and the defence reply have been submitted. The purpose of such mediation is for the parties to try to solve the dispute amicably, with the collaboration of a judge (mediator). A lot of cases, including commercial disputes, are finally resolved by such court mediation.

The authors note that parties to construction disputes also frequently attempt out-of-court mediation. The parties may then appoint mediators with the desired background and expertise. Such mediation will be governed by a mediation agreement. Standard mediation rules are available.

Arbitration

A common alternative means of dispute resolution is arbitration, regulated by the Norwegian Arbitration Act, 2004. The Arbitration Act is based on the United Nations Commission on International Trade Law (UNCITRAL) Model Law on International Commercial Arbitration. The parties are, to a large extent, free to agree on the arbitral process.

Arbitral awards cannot be appealed. A (disappointed) party may only bring an invalidity action before the ordinary courts. The threshold for setting aside an arbitral award is very high.

The authors note that the Nordic Offshore and Maritime Arbitration Association (NOMA) has established rules and best practice guidelines. There is a tendency for NOMA to also be used in other areas, including construction disputes. As an alternative, the Arbitration and Dispute Resolution Institute of the Oslo Chamber of Commerce (OCC) offers institutional arbitration. Both NOMA and the OCC have standard rules available for arbitration (including fast-track arbitration) and mediation.

OMAN

Law and Practice

Contributed by:

Jamie Kellick, Nasser Al Shamli, Michael Smale and Amal Al Raisi
Kennedys



Contents

1. General p.479

- 1.1 Governing Law p.479
- 1.2 Standard Contracts p.479

2. Parties p.480

- 2.1 The Employer p.480
- 2.2 The Contractor p.480
- 2.3 The Subcontractors p.480
- 2.4 The Financiers p.480
- 2.5 The Designer p.480

3. Works p.481

- 3.1 Scope p.481
- 3.2 Variations p.481
- 3.3 Design p.481
- 3.4 Construction p.481
- 3.5 Site p.481
- 3.6 Permits p.482
- 3.7 Maintenance p.482
- 3.8 Other Functions p.482
- 3.9 Tests p.482
- 3.10 Completion, Takeover and Delivery p.483
- 3.11 Defects and Defects Liability Period p.483

4. Price p.483

- 4.1 Contract Price p.483
- 4.2 Indexation p.483
- 4.3 Payment p.483
- 4.4 Invoicing p.483

5. Time p.483

- 5.1 Planning and Programme p.483
- 5.2 Delays p.484
- 5.3 Remedies in the Event of Delays p.484
- 5.4 Extension of Time p.484
- 5.5 Force Majeure p.484
- 5.6 Unforeseen Circumstances p.484
- 5.7 Disruption p.485

6. Liability p.485

- 6.1 Exclusion of Liability p.485
- 6.2 Wilful Misconduct and Gross Negligence p.485
- 6.3 Limitation of Liability p.485

7. Risk, Insurance and Securities p.485

- 7.1 Indemnities p.485
- 7.2 Guarantees p.486
- 7.3 Insurance p.486
- 7.4 Insolvency p.486
- 7.5 Risk Sharing p.486

8. Contract Administration and Claims p.486

- 8.1 Personnel p.486
- 8.2 Subcontracting p.486
- 8.3 Intellectual Property p.486

9. Remedies and Damages p.487

- 9.1 Remedies p.487
- 9.2 Restricting Remedies p.487
- 9.3 Sole Remedy Clauses p.487
- 9.4 Excluded Damages p.487
- 9.5 Retention and Suspension Rights p.487
- 9.6 Termination p.487

10. Dispute Resolution p.488

- 10.1 Regular Dispute Resolution p.488
- 10.2 Alternative Dispute Resolution p.488

Kennedys is an international law firm with over 2,400 people across 72 offices, associate offices and co-operations around the world, including in the Middle East. It takes pride in its approachable, straightforward, supportive and distinctive way of working. The firm operates as an extension of clients' businesses to develop enduring global relationships, and its advice is

jargon free, practical and commercially focused. Its purpose is to be the global legal services firm that helps clients find more certainty in an increasingly uncertain world. Drawing on the extensive resources and expertise of its global network, the firm is committed to providing a first-class, professional service to its clients.

Authors



Jamie Kellick is a partner in the Oman office of **Kennedys** and has been practising in the Middle East (Dubai and Muscat) for 14 years; he previously practised in Jersey for 11 years.

This background of advising in a mixed common law and civil jurisdiction has enabled him to swiftly establish himself as an expert in the civil legal law systems of Oman and the UAE. James advises and represents clients across the region, and is currently acting on a number of construction-related dispute arbitrations, in both ad hoc matters in Oman and before the ICC. He also advises clients on non-contentious construction and project-related matters.



Nasser Al Shamli is the founding partner of **Nasser Al Shamli, Advocates & Legal Consultants (NASLAW)**, **Kennedys'** associate firm in the Sultanate of Oman. **NASLAW**

provides local and international clients with litigation advice and representation before the Omani courts and in arbitration proceedings. Nasser's litigation and arbitration practice includes advising and representing clients in contentious utility project disputes and construction-related matters, acting for government employer entities, project companies and contractors. Nasser also acts in non-contentious construction and project-related matters. He has recently commenced appointments as a sole arbitrator in relation to ad hoc Oman arbitration disputes concerning commercial construction matters.



Michael Smale is a senior associate in the Dubai office of Kennedys, specialising in the resolution of construction disputes. He has a wealth of experience in working with

contractors, subcontractors, architects, engineers, surveyors, building inspectors, property managers, certifying parties, contract administrators and their insurers. Michael qualified at a London-based insurance firm in March 2014 before joining Kennedys in November 2014, and relocated to the Middle East in 2022. Much of his work involves technical, high-value, multi-party disputes arising from the use of bespoke and standard format construction contracts. He is experienced in civil procedure, adjudication, arbitration and mediation, as well as non-contentious construction matters.



Amal Al Raisi is an associate in Kennedys' Muscat office, with experience in commercial law, criminal law, labour law and personal law issues. Her clients are well-known international and

local companies. In addition to assisting Kennedys' construction and engineering team, Amal represents clients in front of Primary Courts, Administrative Courts, Police Stations, Public Prosecution and Ministries. She also advises clients on settlements in commercial and personal law issues and has acted in the liquidation of companies. She also regularly contributes to the annual international publication, "Doing Business in Oman".

Kennedys

Office 2/A Salam Gate
Salam Complex
Dohat Al Adab Street
Madinat Sultan Qaboos
Sultanate of Oman

Tel: +968 2270 3650
Fax: +968 2284 2713
Email: jamie.kellick@kennedyslaw.com
Web: www.kennedyslaw.com

Kennedys

1. General

1.1 Governing Law

Article 2 of Sultani Decree 6 of 2021 on the Issuance of the Constitution of the State states that Islam is the religion of Oman, and that Islamic law (Sharia) is the basis of legislation in Oman. For civil and commercial law purposes, however, Oman (as with all other Arab countries) can be considered largely as a civil law jurisdiction.

The Civil Transactions Law, also referred to as the Civil Code (promulgated by Sultani Decree 29 of 2013, which came into force on 6 August 2013), codified existing principles of law, including principles derived from Islamic law and civil jurisprudence. Article 1 of the Civil Code provides that: “Should the present law be void of relevant provision, the court shall rule as per Islamic jurisprudence provisions, if there is no relevant provision, it shall rule as per the general principles of the Islamic Sharia, and if the latter is void of such provision, the court shall rule according to custom.”

Articles 66 to 173 of the Civil Code contain the general principles under Omani law in relation to the formation, interpretation, performance and termination/expiry of contracts. Articles 176 to 200 contain the general principles under Omani law in relation to liability for acts causing harm (similar, but not identical, to the common law concept of “tort”). Articles 220 to 354 contain the principles under Omani law in relation to the effects of obligations.

At Articles 626 to 650, the Civil Code contains a set of provisions dealing specifically with muqawala contracts (independent contracts for making something or performing work in return for compensation, which include construction contracts). These include a number of default

provisions, which will apply in the absence of the parties having agreed their own terms (for example, in relation to the time to complete), as well as mandatory provisions applicable to all construction contracts, such as the decennial liability provisions of the contractor, architect and engineer at Articles 634 to 637 of the Civil Code.

Decennial liability is also a mandatory provision of Sultani Decree 27 of 2016 issuing the Law Regulating the Work of Engineering Consultancy Offices, Article 16 of which provides that the contractor and engineer/architect will be liable for unforeseen ground conditions, where the engineer/architect was responsible for the design and supervision of the works.

Sultani Decree 55 of 1990 promulgating the Commercial Law (usually referred to as the “Commercial Code”) also contains provisions applicable to construction and engineering projects. Article 2 of the Commercial Code provides that: “In defining the rules applied on merchants and commercial activities, the legally recognised contracts shall be taken into account. The said contracts shall become effective upon mere congruence of offer and acceptance unless the articles of this law stipulate otherwise.”

As with the Civil Code, the Commercial Code also prescribes limitation periods that may apply to construction contracts.

1.2 Standard Contracts

Contracts awarded by public authorities are required to use the Oman Standard Form Documents (modelled on early iterations of the FIDIC contracts) with no amendments. Such documents include:

- Sultanate of Oman Standard Documents for Building and Civil Engineering Works – 3rd edition 1981, 4th edition 1999 (both widely used) and, more recently, the 2019 edition;
- Sultanate of Oman Standard Documents for Electrical and Mechanical Works – 1st edition 1987; and
- Sultanate of Oman Standard Form Agreement and Condition of Engagement for Consultancy Services for Building and Civil Engineering Works (1st edition 1987).

Private parties also use the standard forms of contract and can negotiate terms and amendments subject to compliance with the applicable laws of Oman. Private parties also use other standard forms of contract, with the FIDIC suite of contracts widely used across the Sultanate.

2. Parties

2.1 The Employer

Government entities, real estate developers and project companies (utilities, infrastructure) typically act as employer in a construction project in Oman. The rights and obligations of the employer are set out in the Civil Code and the contractual terms agreed. Generally, collaborative working practices are not widely adopted by the construction market in Oman. The relationships between employer, contractor and subcontractor are usually adversarial and led by black-letter law (contractual terms).

2.2 The Contractor

Local construction contractors and local construction contractors with international contractors through a joint venture arrangement typically act as contractor in a construction project in Oman. The rights and obligations of the contractor under a construction contract in Oman

are set out in the Civil Code and the contractual terms agreed between the parties (subject to not being contrary to the law, public policy and Sharia). The relationships between employer, contractor and subcontractor are usually adversarial and led by black-letter law (contractual terms).

2.3 The Subcontractors

Local construction contractors and local specialist contractors typically act in the role of subcontractor in construction projects in Oman. The rights and obligations of the subcontractor under a construction contract in Oman are set out in the Civil Code and the contractual terms agreed between the parties (subject to not being contrary to the law, public policy and Sharia). These can include being passed through the contractor to the employer (on a back-to-back arrangement). The relationships between employer, contractor and subcontractor are usually adversarial and led by black-letter law (contractual terms).

2.4 The Financiers

In Oman, financing is usually sourced through local lenders, international institutional lenders and export credit agencies, or a combination thereof. Islamic finance structures are also available, and provide an alternative to conventional financing.

The rights and obligations of the financier under a construction contract in Oman are set out in the contractual terms agreed between the parties. The financier's rights are usually treated on a priority basis, and are protected through the use of direct agreements.

2.5 The Designer

Designers, in the form of architects and engineers, acting in the Sultanate of Oman range from multinationals with branch offices in the jurisdiction to independent local entities. Gov-

ernment organisations and entities – such as the Ministry of Housing and Urban Planning, Royal Court Affairs and city municipalities – also act in a design capacity for government and quasi government projects.

For government projects, the rights and obligations of the designer under a construction contract will usually be set out in the Sultanate of Oman Standard Form Agreement and Condition of Engagement for Consultancy Services for Building and Civil Engineering Works (1st edition 1987). Sultani Decree 27 of 2016 issuing the Law Regulating the Work of Engineering Consultancy Offices is also relevant, as it provides a mandatory provision concerning decennial liability (as does the Civil Code). Article 16 of the former provides that the contractor and engineer/architect will be liable for unforeseen ground conditions, where the engineer/architect was responsible for the design and supervision of the works.

The relation between engineer/architect and the parties under a construction contract is significant as, in addition to providing architecture and engineering services, the engineer/architect would also usually provide project supervision and project management services, thus significantly liaising with both parties on the project.

3. Works

3.1 Scope

The scope of works will be set down in the contract, usually through specifications, drawings and Bills of Quantities programmes.

3.2 Variations

The scope and price for variations are determined in accordance with the contractual terms agreed. If variations also result in time exten-

sions for the completion of the works, in addition to additional works costs, additional claims can be sought for the time extension and the associated additional prolongation costs.

3.3 Design

Responsibilities regarding the design process are divided between the employer, the designer, the contractor and other parties as per the contractual terms agreed between each of them.

Decennial liability is also a mandatory provision of the Civil Code (Articles 634 to 637) and Article 16 of Sultani Decree 27 of 2016 issuing the Law Regulating the Work of Engineering Consultancy Offices, both of which provide that the contractor and engineer/architect will be liable for unforeseen ground conditions, where the engineer/architect was responsible for the design and supervision of the works.

3.4 Construction

Responsibilities and risks regarding the construction process are divided between the employer, the contractor, the subcontractors and other parties as per the contractual terms agreed between each of them.

Generally, the employer will be responsible for providing access to the site and payment to the contractor for performance of the contract/execution of the works. The engineer/consultant will supervise the contractors' execution of the project, and may also provide the design. The contractor will execute the construction works as per the contract requirements.

3.5 Site

Usually, as a starting point, the employer would be responsible for the status of the construction site and timely access to it, unless and until said risk is passed to the contractor (the usual

position), with the contractor having confirmed that a site visit has been undertaken and such responsibilities/risks are expressly accepted by the contractor within the contractual terms agreed.

3.6 Permits

The consents, permits and licences for a construction process are project-specific, but the following would usually be required from a regulatory perspective for both temporary construction site and permanent project facilities.

Before

- Site/plant approval from the Ministry of Housing and Urban Planning, the Environmental Authority, the Authority for Public Services Regulation and local municipalities.
- Preliminary environmental permits from the Environmental Authority.
- No Objection Certificates for construction of the building/plant from the local municipality and the Environmental Authority.
- Excavation permits from the local municipality, the Environmental Authority, the Ministry of Housing and Urban Planning and the Royal Oman Police (ROP)/Civil Defence.
- Approval for temporary facilities (temporary construction site) from the local municipality and the Environmental Authority.
- ROP approval of site drawings.
- Electrical line site clearance from the Ministry of Housing and Urban Planning and the regional electricity distribution company.

During

- Permits for the transportation of heavy plant and equipment and for the transportation of hazardous waste from ROP.
- Permission for the installation of sign boards from the local municipality.

- Waste disposal consents from the local municipality and the Environmental Authority.

On Completion

- Municipality permits, such as a certificate of completion.
- Electricity and water supply connection approval from the relevant distribution company and the Authority for Public Services Regulation.
- A fire safety certificate from the Director-General of Civil Defence.

In case of non-compliance with the permit terms and conditions, the permit holder may be fined and/or the permitted activity may be suspended, until the conditions are satisfied.

The parties responsible for obtaining said permits and approvals will be set out in the contractual terms agreed.

3.7 Maintenance

Unless directly incorporated into the main construction contract (ie, DBOOM or DBOM-type contracts), any maintenance obligations after the defects liability period (DLP) will usually be set out in a separate maintenance agreement.

3.8 Other Functions

Operation, finance and transfer services are usually performed in construction-related projects separate to the construction contract (except for own and operate type contracts – ie, O&M, DBOOM or DBOM type contracts).

3.9 Tests

Testing and completion requirements and responsibility will be specifically set out in the contractual terms.

The tests required upon completion of the project are usually undertaken by the main contractor, or by specialised subcontractors under the main contractor's responsibility.

3.10 Completion, Takeover and Delivery

The processes of completion, takeover and delivery of a project in Oman will be set out in, and performed in accordance with, the specific (or standard) contractual terms agreed.

3.11 Defects and Defects Liability Period

Apart from the mandatory obligation of decennial liability (Article 634 of the Civil Code and Article 16 of Sultani Decree 27 of 2016 issuing the Law Regulating the Work of Engineering Consultancy Offices), the DLP will be as per the agreement of the parties (usually 12 months).

In the event of a defect in the works or design subsequent to the DLP, liability can be pursued in accordance with the contractual requirements and prevailing law. For any defects discovered during the DLP, the contractor will usually be required under the contract to remedy the defects or to complete outstanding works (including those referred to in the taking-over certificate) in a timely manner. Many construction contracts will provide that the contractor's failure to comply with its obligations during the DLP will entitle the employer to call in the performance bond.

4. Price

4.1 Contract Price

Both lump sum (fixed price – with the ability to vary as per the contractual terms) and measurable (re-measurement or “measure and value”) contracts are typically used in Oman. Milestone payments are generally adopted.

4.2 Indexation

Indexation is not typically used in construction contracts in Oman, but fluctuation clauses increasing the contract sum, in the form of change of law clauses, are common. Subject to the terms of such clauses, the risk of an increase in the contract sum arising from “change of law” events is usually passed to the employer.

4.3 Payment

The contractual arrangement will set out the circumstances in which payments are to be made. Standard types of “right to payment” are based on lump sum arrangements or quantum meruit basis (reasonable sum claim). Typical measures for late payment include a claim for interest. If expressly included in the contractual terms, suspension of the performance of the contract can be triggered for non-payment (although this is unusual in practice). Advance and interim payments are widely adopted.

4.4 Invoicing

Typically, one would see applications for interim payment certificates for subsequent certification by the engineer and payment by the employer.

5. Time

5.1 Planning and Programme

Planning is arranged prior to the commencement of the construction contract and approved by the employer, resulting in an agreed programme. Updates and amendments to the baseline programme can be agreed throughout the project. The issuance of milestone payments or certificates is usually connected to the programme's deliverables.

5.2 Delays

The extension of time provisions that appear in the Oman Standard Form Documents and the FIDIC suite of contracts are followed/adopted by parties to construction contracts in Oman. In some instances, parties are also able to negotiate their own provisions. Obligations, time-related costs and concurrency are dealt with as per the contractual terms.

5.3 Remedies in the Event of Delays

If specifically included in the contractual terms, the remedy available to the employer would be liquidated damages (usually capped to a percentage of the overall contract price). For the contractor, any non-excusable delays on the part of the employer should result in the contractor receiving an extension of time to the contractual completion date and associated costs (subject to contractual terms).

5.4 Extension of Time

In accordance with the contractual provisions agreed between the parties, the contractor would normally issue a claim for an extension of time, formulated as per the employer's requirements. Extensions of time would normally be awarded if it is agreed, or proven, that there has been "employer prevention". Delay and quantum expert assistance would be required in order to prove the claim before the employer or, subsequently, in any dispute resolution proceeding.

Where the contract is silent in this regard, Article 631 of the Civil Code provides that: "The contractor is required to complete the work under the terms of the contract during the period agreed upon; in case of the lack of agreement on either the terms or a period, he shall be obliged to complete the work according to the customary rules of practice within a reasonable time as required by its nature."

5.5 Force Majeure

Whilst the concept of force majeure is recognised under Omani law, there is no specific definition of a force majeure event. Therefore, it is possible to contractually limit or exclude certain circumstances from being qualified as force majeure in Omani law-governed contracts.

The Oman courts have held that a force majeure event would be any event that prevents a party from performing its obligations under the contract for reasons that were outside of its control and that were not reasonably foreseeable.

Pursuant to Article 172 of the Civil Code, as expressly included within its terms, the contract may be suspended or terminated due to a force majeure event, with the law accepting the non-performance of obligations during the term of the event.

Article 172 provides as follows:

"(1) In bilateral contracts, if force majeure occurs rendering the performance of the obligation impossible to complete, the corresponding obligation shall be extinguished, and the contract shall automatically be revoked.

(2) Where the impossibility is partial, only the corresponding obligation to that part which becomes impossible to be performed shall be extinguished. Such provision shall also apply to temporary impossibility in permanent contracts.

In both cases, the creditor may rescind the contract provided that a notice is served to the debtor."

5.6 Unforeseen Circumstances

Article 159 of the Civil Code give the Omani courts discretion to vary the terms of a contract

in favour of an obligor if continued performance of the contract has become “oppressive”, provided the circumstances in question are “exceptional” and “public”, and could not have reasonably been foreseen by the contracting parties at the time of their agreement.

Article 159 provides as follows: “If general exceptional accidents that were unforeseen at the time of contracting occur and result in the execution of the contractual obligation, even if not impossible, becoming burdensome to the debtor and threatening the latter with serious loss, the court may, according to the circumstances and after balancing the interests of both parties, reduce the burdensome obligation to a reasonable limit. Any other agreement to the contrary shall be void.”

5.7 Disruption

Although the concept of disruption is widely accepted in the Oman construction market, there is no specific mechanism for a disruption claim in the Oman Standard Forms of Contract (or FIDIC for that matter). Accordingly, for a successful claim of disruption, the contractor is usually required to:

- clearly identify those activities affected by the alleged disruption;
- establish that the disruption (and any loss that flows from it) arose from a breach of contract;
- demonstrate that progress has been adversely affected by the disruption complained of; and
- quantify the costs resulting from the disruption.

As with the general conditions to prove contractual liability under Oman law, the compensation claimed should not be too remote and there

should be a causal link between the breach and the damage occasioned.

6. Liability

6.1 Exclusion of Liability

Liability arising from gross fault or civil fraud (the latter of which is akin to fraudulent misrepresentation) cannot, as a matter of law, be excluded. Any contractual provision that seeks to so exclude liability in such circumstances will be considered void.

6.2 Wilful Misconduct and Gross Negligence

The concept of gross fault (similar to wilful misconduct and gross negligence) is recognised by Oman jurisprudence, but is not a defined term as a matter of law.

6.3 Limitation of Liability

Parties are generally able to exclude or limit liability as required. However, any terms that seek to limit a right otherwise required by Omani law (decennial liability, gross fault or fraud) shall be held void. Under the Omani Standard Forms of Contract, it is the employer’s liabilities that are generally limited.

7. Risk, Insurance and Securities

7.1 Indemnities

Indemnities are generally used in Oman to limit risk. Parties can indemnify others to cover a whole host of eventualities in relation to claims, losses, damages, etc, arising from loss and/or damage to property, injury, disease, death, environmental liabilities, etc.

7.2 Guarantees

The usual guarantees seen in construction contracts are advance payment guarantees and performance guarantees provided to the employer by the contractor. Such guarantees are usually required to be provided by a reputable domestic bank (although these can be supported by contra foreign bank guarantee), and it is the terms of the guarantee that shall prevail and are distinct from the construction contract.

Parent company guarantees can be provided in certain circumstances.

7.3 Insurance

Omani law does not specify which insurance policies are required to be obtained for the performance of a construction contract. However, some of the following policies are required under the Oman Standard Forms of Contract, whilst others are usually included under common industry practice:

- third-party liability insurance;
- workman's compensation insurance;
- vehicle insurance (third party);
- professional liability insurance; and
- contractor all risks insurance.

7.4 Insolvency

For contractor insolvency, the contractual terms agreed would normally provide for an automatic termination of the contract (as is the position in the Oman Standard Forms of Contract). Such provisions do differ between the parties, usually favouring the employer over the contractor.

7.5 Risk Sharing

The allocation of risk is as per the contractual terms agreed between the parties, but with the reality being that the contractor shoulders the most risk, even under traditional procurement

type contracts. Subject to competitive bid tendering, the allocation of risk is usually reflected in the contract price, with different mark-ups adopted by the contractor commensurate to the risk allocation. Risk sharing between the parties will be reflected in the overall price paid by the employer.

8. Contract Administration and Claims

8.1 Personnel

The employer would usually have a great deal of power over whom the contractor employs on the project. Strict labour laws and limits on personal behaviours are expressly referred to and set out in the Oman Standard Forms of Contract.

8.2 Subcontracting

Main contractors are entitled to subcontract part of their performance obligation to subcontractors, which is the usual position in Oman construction projects. The extent to which they may do so may be limited by the contractual provisions. The parties are free to negotiate and agree contractual protections in respect of their subcontracting arrangements, although it is normal to see "back-to-back" provisions existing in subcontracts, resulting in the subcontractor's rights being subject to the employer's rights over the contractor.

8.3 Intellectual Property

A party's IP protections would be expressly set out in the contractual terms and usually provide for a licence permitting one party to use the other's IP in its performance of the contract.

9. Remedies and Damages

9.1 Remedies

Pursuant to Article 258(1) of the Civil Code, the remedy of specific performance is available for a party that has suffered a breach and seeks performance of the other's obligations. In circumstances where the specific performance would be considered to be "overly oppressive for the debtor" (Article 258(2) of the Civil Code), monetary compensation will be awarded instead.

The employer would usually reserve an express unilateral right to termination of the contract if the contractor seriously breaches its obligations/performance, although more suspension rights for the contractor are now being seen, particularly in circumstances where the employer has failed to make payment when contractually required to do so.

9.2 Restricting Remedies

Contractually capping the damages recoverable under a liquidated damages clause is common practice (usually to 10% of the contract price) and is considered to be the only or main restriction on the remedies sought (save in relation to limitations of liability legally valid and expressly set out in the contract). Claims for consequential or indirect loss are restricted as a matter of law/jurisprudence.

9.3 Sole Remedy Clauses

Sole remedy clauses are used in construction contracts relating to liquidated damages. However, pursuant to Article 267(2) of the Civil Code, upon an application of either party, liquidated damages provisions can be amended by the courts in order to make the compensation equal to the actual damage sustained. Any agreement to the contrary will be considered void.

9.4 Excluded Damages

All damages that cannot be proven to have directly resulted from the breach will be excluded from liability. Otherwise, contractual clauses that exclude claims for loss of profit, loss of future profits, or indirect or consequential loss are generally enforceable under Oman law, as long as they do not contravene mandatory laws or public policy.

9.5 Retention and Suspension Rights

Retention requirements are common in Oman law-governed construction contracts. 10% of the contract price, retained from each interim payment, is usually stipulated by the employer, 5% of which is released back to the contractor once taking over of the works is complete and the other 5% after the expiration of the defects liability period.

Suspension rights are not usually excluded from Oman law-governed contracts; indeed, they are becoming more common in Oman law-governed construction contracts.

9.6 Termination

A contract of muqawala shall terminate upon the completion of the work agreed or by the cancelling of the contract by consent or court order (Article 646 of the Civil Code). In such circumstances, the contractor, as a matter of law, shall be compensated to the value of the works performed. Contractual terms may provide additional remuneration. In any event, any party that incurs losses as a result of the termination may be entitled to claim damages.

Article 167 of the Civil Code provides that: "The contracting parties may not rescind or modify a contract that is valid and binding unless by mutual agreement or legal action."

Article 170 provides as follows: “It may be agreed that a contract be automatically revoked without the need of a court order in case of any default in the performance of any obligations arising therefrom. Said agreement shall not exempt from a notice thereof unless the contracting parties have expressly agreed on the exemption therefrom.”

10. Dispute Resolution

10.1 Regular Dispute Resolution

Any disputes being referred for determination will proceed according to the dispute resolution terms of the particular construction contract.

Pursuant to the dispute resolution terms of the Omani Standard Forms of Contract, post-engineer determination disputes are referred to ad hoc arbitration in accordance with Sultani Decree 47 of 1997, as amended, issuing the Law of Arbitration in Civil and Commercial Disputes.

Construction disputes, as is the case with all other disputes, can be determined by the courts of Oman where the contractual provisions provide for such or are silent on the matter, or where the court assumes jurisdiction.

10.2 Alternative Dispute Resolution

Arbitration is a commonly used dispute resolution method for construction-related disputes; the Oman Standard Forms of Contract expressly provide for arbitration. However, a pre-step in the dispute resolution mechanism under these contracts is the requirement that the engineer first provides a determination.

Private parties may agree on alternative dispute resolution methods, such as mediation, which would seem to be gaining some traction in the Oman disputes arena. Resorting to Dispute Adjudication Boards (DAB) is also becoming increasingly popular, particularly for those parties that have entered into a FIDIC-based standard contract with DAB provisions.

QATAR

Law and Practice

Contributed by:

Claudia El Hage, Myriam Eid and Maryline Zghaib
Al Marri & El Hage Law Office



Contents

1. General p.493

- 1.1 Governing Law p.493
- 1.2 Standard Contracts p.493

2. Parties p.494

- 2.1 The Employer p.494
- 2.2 The Contractor p.494
- 2.3 The Subcontractors p.495
- 2.4 The Financiers p.495
- 2.5 The Designer p.496

3. Works p.498

- 3.1 Scope p.498
- 3.2 Variations p.498
- 3.3 Design p.499
- 3.4 Construction p.499
- 3.5 Site p.500
- 3.6 Permits p.500
- 3.7 Maintenance p.501
- 3.8 Other Functions p.501
- 3.9 Tests p.501
- 3.10 Completion, Takeover and Delivery p.501
- 3.11 Defects and Defects Liability Period p.501

4. Price p.502

- 4.1 Contract Price p.502
- 4.2 Indexation p.502
- 4.3 Payment p.503
- 4.4 Invoicing p.503

5. Time p.504

- 5.1 Planning and Programme p.504
- 5.2 Delays p.504
- 5.3 Remedies in the Event of Delays p.505
- 5.4 Extension of Time p.505
- 5.5 Force Majeure p.506
- 5.6 Unforeseen Circumstances p.507
- 5.7 Disruption p.507

6. Liability p.508

- 6.1 Exclusion of Liability p.508
- 6.2 Wilful Misconduct and Gross Negligence p.508
- 6.3 Limitation of Liability p.508

7. Risk, Insurance and Securities p.509

- 7.1 Indemnities p.509
- 7.2 Guarantees p.509
- 7.3 Insurance p.509
- 7.4 Insolvency p.510
- 7.5 Risk Sharing p.510

8. Contract Administration and Claims p.511

- 8.1 Personnel p.511
- 8.2 Subcontracting p.511
- 8.3 Intellectual Property p.512

9. Remedies and Damages p.512

- 9.1 Remedies p.512
- 9.2 Restricting Remedies p.513
- 9.3 Sole Remedy Clauses p.513
- 9.4 Excluded Damages p.513
- 9.5 Retention and Suspension Rights p.513
- 9.6 Termination p.514

10. Dispute Resolution p.514

- 10.1 Regular Dispute Resolution p.514
- 10.2 Alternative Dispute Resolution p.515

Al Marri & El Hage Law Office (MHLO) has a diverse team of specialised lawyers that provides legal consultancy and represents international or local firms and institutions in litigation (before the state courts and QICDRC), including in arbitration, mediation, alternative dispute resolution proceedings and all related procedures, in Qatar or abroad (Saudi Arabia, UAE, Oman, Lebanon, Iraq, Jordan, France, the UK, Greece,

Italy, Spain and Singapore). MHLO is a fully fledged office that provides professional legal services in various areas of the law and on a wide variety of issues. MHLO has been recognised by Chambers and Partners Middle East as Qatar Law Firm for three consecutive years (2022, 2023 and 2024), and for its strengths in international arbitration as a diligent and effective law firm.

Authors



Claudia El Hage is a managing partner at MHLO and acts as a legal consultant, litigator, arbitrator and legal expert on civil law. She mainly specialises in construction, contracting,

engineering consultancy, property and real estate, corporate, banking and M&A. She advises international and local firms on their projects, with a focus on the MENA region and Europe. She has advised and represented clients in litigation, ADR, compliance, regulatory investigations and annulment recourses in relation to various disputes and transactions. Claudia also advises on corporate and commercial matters, as well as in business criminal cases and regulatory investigations. Her practice provides essential legal counsel to many international, regional and local companies and corporations.



Myriam Eid is head of MHLO's arbitration and ADR practice and has extensive experience in the conduct of international arbitration proceedings, especially involving complex

construction disputes. Myriam frequently advises contractors and state entities on the resolution of complex disputes. She has been involved in a substantial number of international arbitration proceedings under different arbitration rules (ICC, LCIA, QICCA, SIAC, DIAC, CRCICA) and substantive laws (Qatar, Saudi Arabia, Lebanon, Egypt, Bahrain, UAE, France, and England and Wales). She has also led several arbitration proceedings where she managed the case from cradle to grave, including oral pleadings and cross-examinations.



Maryline Zghaib works in a diverse range of litigation cases, involving civil disputes, commercial conflicts, arbitration cases and business criminal cases. She conducts legal

analysis and research of case law, statutes and codes, and develops and builds case strategies in litigation and arbitration. She also assists in the preparation of trial documents and assists in other legal responsibilities.

Maryline holds a master's degree in International Business Law from the University of Poitiers France.

Al Marri & El Hage Law Office

Grand Hamad Street 810
Al Fardan Center Building 36, Floor 3
Old Ghanim 6
Qatar

Tel: +974 444 306 51
Email: admin@marri-hage.com
Web: www.marrilaw.com



المري و الحاج
AL MARRI & EL HAGE
LAW OFFICE مكتب محاماة
QATAR | LEBANON

1. General

1.1 Governing Law

Qatar is a civil law jurisdiction that relies on enacted laws and, in their absence, on Sharia principles. Judgments serve as guiding principles for lower courts when issued by the Court of Cassation.

Construction contracts are primarily governed by the following laws:

- the Civil Code (Law No 22/2004) – Articles 682 to 712 and Articles 324 to 336 on the assignment of rights;
- the Commercial Code (Law No 27/2006) – the obligations arising from a construction contract are commercial obligations, including Articles 406 to 413 on on-demand irrevocable guarantees;
- the Labour Law (No 4/2004); and
- the Wages Protection System, introduced by the Ministry of Labour in 2015.

Specific laws and regulations have also been issued in relation to contracts involving state entities in Qatar:

- Law No 24/2015 on tenders and bids with state entities, issued on 13 June 2016, and amended by Decree Law No 18/2018;
- Ministerial Resolution No 16/2019, the Implementing Regulation to the Tender Law, amended by Cabinet Resolution No 11/2022;
- Law No 9/2005 amending certain provisions of Law No 1/2004, which governs contracts with the Public Works Authority (PWA);
- Law No 15/2004 on the establishment of the general authority for urban planning and development;
- Law No 12/2020 on the regulation of public-private partnerships (PPPs);

- Law No 19/2005 on the engineering profession;
- Law No 7/2007 on the resolution of administrative disputes; and
- Arbitration Law No 2/2017.

The laws and unofficial English translations thereof are available on the Al-Meezan Portal [here](#).

1.2 Standard Contracts

Article 171 of the Civil Code sets out the principle of the binding effect of contracts. Hence, parties are free to agree on the terms of their construction contracts, provided they do not contravene mandatory provisions, public order or morality as set out under Qatari law. There are no specific formalities for the validation of a construction contract.

Standard forms of contracts are generally used by government entities, and each has its own forms, which are generally based on the FIDIC provisions and procedures, with amendments.

For governmental projects, most state entities have tailored their own contract templates for construction, engineering and procurement contracts. This is the case for the PWA, Hamad International Airport, Qatar Rail, Qatar Energy (formerly Qatar Petroleum), Kahramaa and Qatar Gas, in addition to other state entities.

Where a state entity is involved, construction contracts may qualify as administrative contracts. The Qatari Court of Cassation has held that a contract would qualify as administrative if:

- the contract is concluded between a private party and a state entity;
- it relates to performance of a public service; or

- it shows the state entity's intention to use its public prerogatives, which are exceptionally granted under Qatari public law, by expressly including them or referring to the relevant applicable statutes (Qatar Court of Cassation, Civil and Commercial Circuit, Decision No 100/2016, dated 26 April 2016).

2. Parties

2.1 The Employer

Employers in Qatar are typically as follows:

- government entities (such as the PWA, Qatar Foundation, Qatari Diar, Qatar Rail, Kahramaa, ministries, Supreme Committee for Delivery and Legacy, Hamad International Airport, Musheireb Properties, Qatar Energy, Qatar Gas and others); and
- private investors (Qatari nationals or foreigners), mainly for real estate development and industrial projects.

An employer's obligations under a construction contract are generally set out under law, particularly Articles 692 to 700 of the Civil Code (relating to service contracts), and include the following.

- The performance of any acts that are deemed necessary for the completion of the works, upon notice from the contractor (Article 692(1)).
- Taking over the works once completed, upon notice from the contractor in accordance with trade customs. The employer's failure to take over the works without a legitimate reason is deemed an acceptance of the works (Article 693). Exceptions to this provision are set out under Article 694 Civil Code.
- The contractor's notification of any latent defects in the works within a reasonable peri-

od from the taking-over date, subject to being considered as having accepted the defects.

- Payment of the contractor's fees for the works/services upon taking over, unless otherwise determined in the contract or trade usages, including partial payments for partially completed works (Article 689).

The employer's rights include:

- completion of the project within the time periods and conditions of the contract, failing which, the employer has the right to terminate or continue the works at the contractor's cost;
- provision by the contractor of materials and labour, as required for the completion of the works at the contractor's cost, unless otherwise agreed; and
- rectification of any defects in the works, failing which, the employer is entitled to terminate the contract or to perform the works at the expense of the contract.

2.2 The Contractor

The following companies generally act as contractors in Qatar – they include local and/or international companies, depending on the complexity and types of the projects (airports, stadia, infrastructure, oil and gas plants, rail, hospitals, malls, hotels and energy plants):

- joint ventures between international construction conglomerates;
- joint ventures between state-owned entities and international construction conglomerates;
- engineering, architecture, planning, environment or project management consultancy firms;
- procurement companies;
- mechanical and electrical contractors;

- specialty contractors which focus on specific trades or specialised areas of construction; and
- design-build contractors.

The contractor's rights as set out in the Civil Code are as follows.

- To be paid for completed works.
- To request performance by the employer of any acts that are deemed necessary for the completion of the works, failing which, the contractor would be entitled to terminate the contract without prejudice to its rights to compensation.
- To compel the employer to take over the works once completed upon notice, failing which, the employer is deemed to have accepted the works. Exceptions to this provision are set out under Article 694 Civil Code.

The contractor's general obligations include the following (Articles 696 to 691 Civil Code).

- Completion of the works in accordance with the agreed terms and periods or, failing which, within a reasonable period as required by the nature of the works and the relevant trade usages. Any irremediable delays to the completion date would entitle the employer to terminate the contract.
- Provision of materials and labour as required for the completion of the works, unless otherwise agreed.
- Remedying any defects in the works upon notice from the employer.

2.3 The Subcontractors

The kind of company that acts as subcontractor depends on the scale of the project and the nature of the work that is being subcontracted (such as electrical and mechanical works, civil

works/core and shell, waterproofing, plumbing and HVAC, carpentry and joinery, flooring, painting and decoration, steel and metal work, scaffolding, landscaping and other specialised trades). In certain projects, a member of the joint venture would also act as subcontractor for the joint venture.

As back-to-back subcontract models are widely used in Qatar, subcontractors have generally the same rights and obligations as those of the contractors towards the employer with regards to the subcontracted work, subject to the specific requirements of each subcontract.

Articles 701 and 702 of the Civil Code include specific provisions for subcontract agreements.

- Contractors are authorised to subcontract all of or parts of the work to a subcontractor if authorised under the main contract, but remain fully and exclusively liable for such work towards the employer.
- The subcontractor has a direct recourse against the employer with regards to any amounts owed to it from the contractor, within the limits of the value of any debts the employer has towards the contract at the date of the initiation of the lawsuit.

Subcontractors generally seek funding from financial institutions through financial facilities/tender bonds (advance payment guarantee and retention bonds) in addition to other facilities, against which they generally assign the proceeds of the project to the bank. These facilities are generally similar to those obtained by the contractors under the main contract.

2.4 The Financiers

There are two main financiers in Qatar: the government and the banks. Administrative contracts

are financed by the government (eg, Ministry of Finance).

The Qatar Investment Authority (the sovereign wealth fund, with a portfolio worth USD360 billion in 2022) provides funding – generated mainly from gas and oil revenues – for strategic projects abroad.

For public-private partnerships (PPP), the state has determined the implementation of a partnership between the two sectors, including financing, through:

- diversifying sources of income;
- reducing dependence on oil and gas; and
- increasing direct foreign investments.

This is in accordance with one of the following model types:

- allocation of land through a lease or a usufruct right, for development by the private sector;
- build-operate-transfer (BOT);
- build-transfer-operate (BTO);
- build-own-operate-transfer (BOOT);
- operation and maintenance (O&M); and
- any other model adopted by the Council of Ministers on the proposal of the Minister.

For contractors, subcontractors and suppliers in the private sector, banks remain the main financiers in construction projects, in addition to a number of investment funds (private equity firms, infrastructure funds and real estate funds).

Regarding the relationship between the various parties – for example, in administrative contracts – the employer would generally fund the project, and the contractor and subcontractors would respectively obtain facilities from a bank against:

- an assignment of proceeds of the contract/subcontract;
- a personal guarantee of all the shareholders, against the facilities;
- a first-degree mortgage on assets; and
- a collateral in certain cases (though rarely).

2.5 The Designer

Companies that typically act as a designer in Qatar must be licensed by the Ministry of Municipality and Urban Planning (MMUP) or the Qatar Financial Centre Authority (QFCA), and may be local, regional or international. They generally include the following.

- Architectural firms: these firms specialise in architectural design and may provide services such as conceptual design, detailed design and construction documentation.
- Design-and-build contractors: some construction companies offer design-and-build services, where they are responsible both for the design and the construction of the project. In such cases, the contractor acts as the designer as well.

Design consultants: these are independent consultants or firms that provide specialised design services for specific aspects of the project, such as interior design, landscape design or sustainable design.

Article 5 of Law No 19 of 2005 regulating the practice of engineering professions sets out a list of conditions for a person/entity to be eligible to join the register of engineers – including designers – and which is summarised below.

To enrol in the register of engineers, individuals must:

- be Qatari citizens or residents;

- hold a Bachelor of Engineering degree from a recognised institution;
- have full civil capacity; and
- pass technical ability tests.

For local offices of engineering consultancies, the office must:

- be owned by Qatari individuals or entities;
- employ engineers enrolled in the register of engineers with necessary experience; and
- designate responsible engineers according to set standards.

For international offices of engineering consultancies, the branch office must be a licensed branch of a main office abroad, supported by the main office, with a proven track record of at least ten years. The engineer in charge must:

- be registered in the Engineers Register;
- hold a relevant specialisation certificate; and
- have a minimum of ten years of professional experience.

Other engineers in the branch office must meet conditions outlined in implementing regulations.

The MMUP has introduced updated construction codes to align with international best practices, covering aspects such as building materials, structural design, fire safety and sustainability. By enforcing these codes, the MMUP aims to ensure that construction projects meet the highest standards of safety, durability and environmental responsibility.

Under the QFC, two special legal stipulations address the licensing of engineering/design consulting services within the QFC legal framework. Both stipulations are part of the Non-regulated Activities Rules Version 2 – October 2023.

For context, the activities permitted to QFC entities are either regulated or non-regulated activities. The former are generally financial services and are regulated by the QFC Regulatory Authority. The latter are the various engineering/design consulting services that form permitted activities falling under “professional services”, as provided under Schedule 5(G) of the QFCA Rules (Version No 17 – October 2023).

The Civil Code does not include a section on the rights and obligations of designers in construction contracts, which remain subject to party autonomy and the agreed terms of each contract. Where there is no specific agreement, the general principles of contract law set out under Articles 169 to 175 would apply.

In addition to the above, and in the absence of any agreement to the contrary, Articles 712 and 713 include specific provisions regarding the designer’s liability in construction matters.

If the architect/designer has only provided the design of a construction or establishment, they may only be held liable for the defects relating to the design they have produced, and may not be held liable for the manner through which it was executed (Article 712(1)).

However, if the designer/architect also undertook the supervision of the execution/performance, they would also be liable for any defects resulting from the manner in which the design was performed (Article 712(2)).

The contractor remains liable for defects pertaining to errors in design if such errors were apparent in accordance with trade usages (Article 713(1)) and for any design defects if the designer works for the contractor.

Article 711 of the Civil Code further stipulates a mandatory decennial and joint warranty on the part of the contractor and engineers for structural defects (including defects that would compromise the structure's safety or risk its collapse) that cannot be set aside by agreement. This starts running from the taking-over date and is subject to a limitation period of three years from the date the structural defect is discovered.

3. Works

3.1 Scope

The method for description of the scope of work varies depending on the type and size of the project, but is generally similar to the methods used in international contracts, and will likely include:

- tender documents and specifications;
- a programme of requirements (the functional and operational requirements of the project);
- specifications, which provide detailed technical information on the materials, products, systems and workmanship required for the project;
- performance specifications, which focus on the intended results and set out performance criteria that the project should achieve;
- a programme of works and method statements;
- drawings (including architectural, structural, mechanical and electrical drawings), which are graphical representations of the project design;
- a bill of quantities (BOQ), which is a detailed document that lists all the project's components or items, along with their quantities and unit prices, and which assists in cost estimation and tendering;
- tender circulars and qualifications; and
- general and particular conditions of contract.

3.2 Variations

Qatari law does not have specific provisions on variations; these are generally negotiated and agreed on by the parties. The specific provisions within the Civil Code relating to contracts of services cover events where the performed works have exceeded the scope or the agreed price.

If the contractor's fees were not agreed on, the fees for such work should be assessed based on their value at the time of contracting, as well as on the value of the materials supplied by the contractor and required for the works. These provisions may serve as a preliminary basis for the evaluation of variations as they are considered works, whose price was not determined in the contract (Article 699 Civil Code).

For remeasurement contracts, if during the progress of the work it is deemed necessary to considerably exceed the assessed measurements in order to perform the agreed design, the assessed expected increase in costs must be notified to the employer by the contractor, failing which, the contractor's rights for the additional costs would extinguish. If the excess is substantial, the employer may terminate the contract, provided that it compensates the contractor for the works performed (Article 708 Civil Code).

For contracts in which prices are based on design, the contractor is not entitled to claim compensation for any variations to the design unless such variation is due to the employer's acts as approved and agreed with the contractor (Article 709 Civil Code).

Although the law does not specifically tackle variations ordered by the employer outside the above-mentioned provisions, the contractor may claim additional compensation based on the above-mentioned articles or general princi-

ples of Qatari law governing compensation laid down under Articles 256 to 263 of the Civil Code. In doing so, the contractor should prove that the additional works were requested by the employer or caused by the employer's fault/breaches (such as delays) and the resulting actual costs.

Time-related costs are part of the damages claimed due to events that were not caused by, or that were outside the control of, the contractor. In this case, and in the absence of any other stipulations in the contract, the contractor may claim such costs as damages under the general principles of the Civil Code (Articles 256, 263 and 268), trade usage and the principle of good-faith performance of contracts.

3.3 Design

The responsibilities regarding the design are usually determined and agreed on between the employer, designer, contractor and other parties, in their respective contracts.

Article 713 of the Civil Code provides that contractors are only liable for defects in the works and not for those in the design, unless the design errors were of such nature that they could not have gone unnoticed by the contractor as per trade usages.

The designer is usually responsible for its designs, and for its compliance with relevant applicable laws and safety measures.

The above-mentioned provisions are not mandatory, and parties remain free to agree on design obligations, which may include the following.

- In standard construction contracts and unless specified otherwise, employers are responsible for the design, which is secured through separate contracts with design companies. In

this case, the contractor has no design obligation but is still required to review the design and highlight any notable errors.

- In design-built contracts, the design is allocated to the contractor, which generally secures it either directly or through engineering and architectural companies that it contracts with for this purpose. In this case, the design is the responsibility of the contractor, which will have the right of recourse against its own designer.

3.4 Construction

The specific allocation of work can vary depending on the terms negotiated in the contract agreements and the nature of the project, but would generally include the following.

Employers:

- project planning and design (unless it is a design-built contract);
- obtaining permits and approvals;
- providing project documentation;
- tender phase;
- financing the project; and
- project supervision.

Contractors:

- project execution;
- project management;
- safety and compliance;
- procurement and material supply;
- quality control and testing; and
- co-ordination between different subcontracts.

Subcontractors:

- specific work packages depending on the specific trades, such as electrical, plumbing,

HVAC, carpentry or other construction-related tasks; and

- co-ordination with the contractor.

Other parties:

- consultants and design professionals – architects, engineers and other design professionals are responsible for providing design services, technical expertise and advice during the planning and design stages of the project;
- regulatory authorities, such as municipalities and governmental bodies, to enforce compliance with building codes, regulations and standards;
- insurers, which provide third-party compensation/insurance; and
- financial institutions, which provide bonds and financial facilities.

3.5 Site

The employer is generally the party responsible for site access, and for geotechnical and ground conditions (including soil risks), unless the related defects were detectable at the time of contracting and accepted by the contractor. For this purpose, the employer is generally responsible for obtaining any permits to secure safe and authorised access to site (including road construction, civil defence, road and traffic permits, and others).

Nonetheless, the ultimate responsibility in this regard depends on the terms of each contract, which may shift to the contractor – as is often the case in turnkey contracts.

3.6 Permits

Specific permits are required in Qatar based on the nature and scope of the project, local regulations and the location of the construction site,

and include the following (prior to commencement).

- Building or construction permits or licences, which are required for any new construction, renovation or extension projects. These are generally obtained from the local municipalities.
- Environmental permits, which may be necessary for projects that have potential environmental impacts, such as those involving significant earthworks, wastewater discharge or hazardous materials.
- Civil Defence approval, which is required to ensure compliance with fire safety regulations and emergency response measures.
- Road closure permits, where construction activities require temporary road closures or disruptions.
- Archaeological permits, which are required in cases where construction activities are planned in areas of archaeological or cultural significance.

In addition to the above, specific certificates are required upon completion of the project. These include:

- fire safety approval from Civil Defence;
- certificate of completion from the Ministry of Municipality and Environment;
- building registration with the concerned municipality;
- utility connections (Kahramaa, Qatar Cool and others); and
- industrial plants.

Engineering consultancy firms in Qatar are required to obtain a licence from the engineering committee in accordance with Law No 19/2005 on the engineering profession.

3.7 Maintenance

Contractors are generally responsible for maintenance after performance of the works and taking over for a contractual period (defects liability period), usually for 400 days. Once the defects liability period is over, the maintenance responsibility shifts to the employer.

Maintenance generally includes regular inspections, cleaning, lubrication, minor repairs and upkeep of the facilities to preserve their proper functioning, appearance and longevity. It also includes preventative maintenance such as servicing equipment, conducting regular inspections and implementing maintenance schedules.

Separate maintenance contracts outlining the specific terms and conditions for ongoing maintenance may be entered into between the employer and the contractor in large-scale projects (such as heavy plants) or with third parties.

3.8 Other Functions

Generally, the employer deals directly with operations and finance. Nonetheless, in specific cases, especially in EPC/turnkey or PPP contracts, such functions may be assigned to the contractor.

3.9 Tests

Generally, the testing and commissioning process is set out in the contract. Taking over or practical completion only occurs when testing is successfully completed. In certain types of contracts, testing may be required even after completion, during what is commonly referred to as the trial operation period.

3.10 Completion, Takeover and Delivery

Article 696(1) of the Civil Code expressly refers to practical taking-over of the works, and provides that, once the works have been taken over by

the employer, whether practically or contractually, the contractor's liability for apparent defects ceases.

The practical completion also triggers the time limit for latent defects, which should be notified to the contractor within a reasonable period as per the applicable trade customs. The employer is required to take possession of the works following a formal notice from the contractor to this effect. The employer's refusal to take possession of the works without just cause amounts to an acceptance of the works (Article 696(2) of the Civil Code). However, the parties remain free to agree to different terms and effects for the completion of the works.

3.11 Defects and Defects Liability Period

Article 87 of the Commercial Code provides that the limitation period for rights arising from commercial acts between merchants, including construction contracts (which are considered commercial acts if concluded by a professional under Article 5(16) of the Commercial Code), is ten years from the date on which such rights have become due. Accordingly, provided that defects are duly notified as per the provisions set out further below, the employer's rights to compensation are subject to the decennial limitation period mentioned above.

The Civil Code provides for the following three categories of defects.

- Apparent defects – defects that can be easily detected through a routine inspection of the works. Under Article 696(1) of the Civil Code, a contractor's liability for such defects ceases on the date the works are taken over by the employer without reservation.
- Latent defects – defects that cannot be reasonably discovered at taking over. Article

696(2) of the Civil Code states that a contractor will be liable for latent defects discovered after taking over, provided that the employer notifies it of such defects within a reasonable period thereafter, failing which, the employer is deemed to have accepted these defects and loses its entitlement to compensation for these defects. As for materials, Article 684 Civil Code provides that a contractor's liability for any defects in the materials is subject to the seller's general warranty for sold products as set out under 432 et seq Civil Code.

- Structural defects – Article of the 711 Civil Code provides for a specific mandatory decennial and joint warranty on the part of the contractor and the engineer for structural defects (including defects that would compromise its safety or risk its collapse). Under Article 714 of the Civil Code, the limitation period to file a lawsuit for decennial liability is three years from the date of discovery of the defect.

Defects Liability Period

Construction contracts generally include a period of time during which the contractor has the right, and also the obligation, to return to the site to rectify any defects in the works at its own expense. This period is commonly known as the defects liability period, rectification period or maintenance period, and generally extends for a period of 400 days from provisional taking-over or practical completion of the works.

4. Price

4.1 Contract Price

The method usually used in general contracts to establish the price is the lump sum contract, and normally the lowest bidder is awarded the contract provided they meet all requirements and

qualifications. Some contracts have provisional sums. For the PPP method for pricing, please see **2.4 The Financiers**.

Some contract prices are based on design and remeasurement (see **3.7 Maintenance**), and a few private contracts are based on cost-plus pricing.

The method of payment usually consists of an advance payment of 10% to 20% of the contract price against a bank guarantee to be monthly amortised, and monthly interim payment certificates linked to progress, concluding with the final account, final payment certificate and release of the retention money.

4.2 Indexation

The indexation of prices is commonly used in construction contracts to mitigate the risk of large price fluctuations, particularly in contracts with long durations. Indexation mechanisms are intended to help parties manage inflation and market changes by linking contract prices to an agreed-upon index, such as the Consumer Price Index (CPI), producer price indices or specific industry indices.

The risk of large price fluctuations is typically divided between parties through negotiation and contractual agreements. The following are some common approaches.

Fixed Price Contracts

The contractor agrees to complete the project for a predetermined, fixed price. Any cost increases or decreases are borne by the contractor subject to special considerations for unforeseen circumstances.

Cost-Plus Contracts

The contractor is reimbursed for the actual costs incurred during construction, plus a predetermined fee or percentage of costs. This arrangement shifts the risk of price fluctuations to the employer, who bears the responsibility for any cost increases.

Price Adjustment Clauses

These clauses allow for adjustments to contract prices based on changes in specified indices, such as inflation rates or material costs. Price adjustment mechanisms can be tailored to allocate risk between parties based on their preferences and market conditions.

Shared-Risk Contracts

Some contracts may include provisions for sharing the risk of price fluctuations between the parties. For example, the parties may agree to a formula that divides cost increases or decreases between them based on predetermined ratios or thresholds.

The allocation of risk of price fluctuations further takes into consideration market conditions, project complexity and the bargaining power of the parties involved. For example, recent global events, such as the COVID-19 pandemic, the Ukraine war and changes in legislation such as Qatar's Minimum Wage Law have led to significant increases in construction costs, and these were addressed on a case-by-case basis, in the absence of any mandatory legislation that provides for compensation to the affected party.

4.3 Payment

Contractors are usually entitled to an advance payment guarantee of 10% to 20% of the contract price against a bank guarantee to secure their cash flow; such amount will be amortised in the monthly interim payment certificates.

Subsequent payments are generally made on an interim basis through monthly progress payment certificates.

As contracts are binding under Qatari law, any provisions for late payment or non-payment of certified payments can be implemented; contractors are generally required to proceed with the works notwithstanding any delay in payments or pending claims in their contracts.

In the absence of such provisions, the following remedies at law are available for a contractor.

- Filing a substantive claim before the courts or arbitrators (depending on the dispute resolution agreement).
- Applying for a preventative attachment order.
- If it holds an executory deed or instrument, the contractor may have recourse to the enforcement judge, in order to issue an attachment order against the employer or its creditors and to enforce its payment right thereon (Articles 408 Procedural Law). In this regard, it should be noted that, under Article 1185 of the Civil Code, the contractors and architects that were instructed to build, reconstruct or repair buildings and other establishments are considered privileged creditors with regard to these constructions in accordance with the terms set out therein.

4.4 Invoicing

Typical means of invoicing may vary depending on the specific contract terms and the parties involved. However, the most common means of invoicing are through interim payment applications, where the contractor submits periodic invoices, usually on a monthly basis, reflecting the work completed during that period. These applications are accompanied by supporting documentation, such as progress reports, meas-

urement sheets and records of materials used. The employer or the employer's representative reviews the application for the purpose of its certification. Each interim payment generally includes the amount of retention monies and recovered advance payments, where applicable.

Once the interim payment is certified, it is issued in the form of an interim payment certificate, which the employer is required to pay within an agreed period from the date of its certification.

Disputed applications or payments are generally subject to a specific procedure provided for in the contract.

5. Time

5.1 Planning and Programme

As mentioned in **5.2 Delays**, programme planning depends on the party responsible for design. The detailed programme of work is then generally required from the contractor.

5.2 Delays

Article 687 of the Civil Code requires the contractor to complete the works within the agreed period or, if no period is agreed, within a reasonable period as required by the nature of the works, taking into consideration trade usages. If the contractor fails to perform the works as per the terms of the contract, Article 688 of the Civil Code requires the employer to issue a notice underlining the defects in performance and setting out a deadline to rectify them. If the deadline elapses without the contractor rectifying such defects, the employer may request the termination of the contract or its completion at the expense of the contractor.

In addition to the above, under Article 689 of the Civil Code, the employer may terminate the contract prior to its term if:

- the contractor is in delay, whether in the commencement or in the performance of the works, which would necessarily affect the completion of the works within the prescribed time period;
- the contractor's actions show its intention to not perform its obligations; or
- there exist any acts that would render performance of the contractor's obligations impossible.

Aside from the applicable legal provisions, construction contracts typically set out the procedure to be followed by the parties if delays occur that would affect the date of completion of the works, which differ depending on whether the delays are due to the employer, the contractor or an external cause.

As the party that is performing the works, the contractor is generally considered as having the necessary information to assess and alert the employer of any delays that would affect the completion of the works, even where these are not attributable to the contractor. The procedure generally applies where there is a critical delay and/or where a delay is likely to affect the completion date or results in additional costs.

In these instances, and whenever it becomes aware of any delaying events, the contractor is required to send a notice within a prescribed time that varies from one contract to another, irrespective of the nature of such events. Failing the timely issuance of such notice by the contractor might lead to banning the latter from its right to an extension of time, as well as to any resulting costs. These clauses are commonly

known as time-bar clauses. The notice is generally followed by a substantiation requirement to provide, within another prescribed time limit, the particulars of its claim, whether for an extension of time or additional costs.

While there is no clear position in case law as to the enforceability of time-bar clauses in Qatar, it remains the case that such clauses lead to imposition of a shorter time limit on the contractor's right to claim compensation than as set out by law (15 years for civil claims and ten years for commercial claims). To this extent, they might be considered as contravening the provisions of Article 418 of the Civil Code, which are mandatory.

Finally, concurrent delays occur where two or more delay events occur at the same time; one as an employer's risk event, the other as a contractor's risk event. In this case, concurrent delays do not become an issue unless both are recorded on the critical path.

Under such circumstances, parties may agree on the procedure to assess concurrent delays and their effects on the parties' rights, and may choose that either:

- the risk is ultimately to be borne by the party having caused the delay with greater magnitude; or
- that when concurrent delays occur, the contractor would be entitled to an extension of time without the associated costs.

In the absence of such agreement and in the event of a dispute, parties often have recourse to experts that would perform the relevant analysis and closely examine the cases of concurrency, to properly identify the responsibilities for delays and to allocate proper entitlements.

5.3 Remedies in the Event of Delays

As mentioned under 5.2 Delays, Articles 688 and 689 of the Civil Code grant the employer the right to either terminate the contract or complete the works at its expense if the delays referred to in these Articles occur.

In addition to the above, the following remedies can be granted.

Liquidated Damages

Construction contracts often include liquidated damages provisions as a form of agreed compensation under Article 263 of the Civil Code, which establish a predetermined amount of damages that the contractor must pay to the employer for each day of delay beyond the agreed completion date, generally capped at 10% of the contract price.

Nonetheless, liquidated damages cease to apply and can be set aside if the contractor proves that the employer did not incur actual losses (Article 266 Civil Code). This Article, which is mandatory, also grants the courts the power to reduce agreed compensation if it was excessive or if the related obligation was partially performed.

On-Demand Bonds

Construction contracts often require contractors to provide bonds (against advance payment, performance, retention) as a form of financial security. In the event of delays or non-performance, the employer may call upon the performance bond to secure compensation for the breach (Articles 406 to 413 of the Commercial Code).

5.4 Extension of Time

Extensions of time are requested in accordance with the procedure set out in the contract, typically through a notice of claim, which should

be submitted within the prescribed time limit (see 5.2 Delays). The grounds for such extension would usually be for any delays that are not caused by the contractor, or that are not concurrent with delays caused by the latter.

The extension-of-time process in construction contracts necessitates adherence to contractual procedures and time-bar provisions for similar claims. This involves clear communication, thorough documentation and adherence to procedural requirements, to ensure fair resolution of delays and of disruptions to the project schedule.

Typically, the extension of time is established, measured and proven through a systematic process outlined in the contract documents. The contract specifies procedures and criteria for granting extensions, including defining events that entitle the contractor to an extension, such as unforeseen site conditions or delays caused by the employer or other contractors.

The contractor is usually obligated to promptly notify the employer of any events that may entitle them to an extension, and to provide supporting documentation for their claim. This documentation may include daily site reports, correspondence, meeting minutes and photographic evidence.

Parties (often with the assistance of contract administrators or project managers) assess the impact of the event on the project schedule by analysing the critical path and identifying delays. The employer evaluates the contractor's claim based on contractual provisions and supporting documentation. If warranted, the employer issues a formal extension-of-time instruction specifying the duration and conditions of the extension.

In cases where parties cannot agree on the entitlement or duration of the extension, dispute resolution procedures outlined in the contract (such as expert determination or arbitration) may be invoked.

5.5 Force Majeure

Force majeure is a civil law concept, by which the occurrence of specific events under specific circumstances would exempt an obligor from liability if such events have prevented it from performing its obligations. While the Civil Code refers in a number of Articles to force majeure and distinguishes it from "external events", it does not define it (see, for example, Article 204 of the Civil Code).

It is therefore recommended that the parties define force majeure in their contract. Where force majeure is not contractually defined, it has been narrowly construed by the Qatari Court of Cassation and considered to occur when it cumulatively meets two conditions: "unforeseeability and irresistibility" (ie, could not have been prevented by the obligor) (Qatari Court of Cassation, Civil and Commercial Circuit, Judgment No 134/2015, dated 25 May 2015).

Where a party has not performed its obligation because of force majeure, it is exempted from liability, whether in relation to performance or to compensation, for any damages incurred by the other party as a result of such non-performance (Articles 188 and 204 of the Civil Code).

Where a contract includes bilateral obligations, if the performance of an obligation has become impossible for external reasons, such obligation extinguishes and so does any reciprocal obligation. The contract is then deemed terminated de jure (Article 188 of the Civil Code).

The consequences of the occurrence of an event of force majeure include:

- suspension of performance until the event ceases;
- extension of time, allowing the affected party additional time to complete the work, whether with or without additional cost;
- reduction of the obligation to a reasonable level (Article 171(2) of the Civil Code);
- exemption from liability for any damages resulting from the non-performance or delay caused by such event;
- contract termination where the event significantly impacted the ability to perform the contract; and
- contract renegotiation to accommodate the impact of the event, such as adjusting the timeline or reallocating responsibilities.

5.6 Unforeseen Circumstances

Article 171(2) of the Civil Code gives the judge the power – in light of the circumstances and while balancing the parties’ interests – to reduce the scope of the obligation to a reasonable limit. This provision is mandatory and cannot be set aside by agreement, where unforeseen exceptional circumstances have occurred and rendered the obligor’s performance financially burdensome.

This typically applies to unforeseen circumstances during the performance of the respective obligations in a construction contract, such as:

- unforeseen ground conditions;
- shortage of material or labour; or
- innovative design conditions that have not been previously tested.

Generally, such events are considered risks ultimately borne by the employer. Nonetheless, given the mandatory nature of Article 171(2) of the Civil Code, even where the parties agree to maintain the obligor’s liability in these events, the contractor would still be entitled to avail itself of the provisions of Article 171(2) of the Civil Code.

5.7 Disruption

Disruption is a technical concept that does not expressly feature in the Civil Code. Nonetheless, the parties are free to define it in their contract. Usually, construction contracts include disruption clauses.

To the extent that disruption relates to an event outside the control of the parties and resulted in the impossibility to perform the obligations, it falls within the meaning of “external events outside the control of the parties” of Article 188 of the Civil Code.

Where such disruption could not have been foreseen and has rendered the performance substantially more onerous, the contractor could request to reduce the obligation or claim compensation for the additional costs (Article 171 of the Civil Code).

Various steps may assist in establishing and measuring disruption and its effects:

- the disruption’s criteria as expressly set out in the contract;
- the substantiation and particulars submitted by the contractor to the engineer or the employer, as the case may be;
- impact analysis, which assists in measuring disruption and involves evaluating the cause, extent and consequences of the disruption on the project schedule, productivity and costs;

- documentation and contemporary records; and
- technical delay expert analysis.

6. Liability

6.1 Exclusion of Liability

Contractual exclusion of liability is recognised and enforceable in Qatar to the extent that it does not contradict mandatory liabilities at law (such as fraud, gross negligence, or illegitimate acts and decennial liability), which cannot be set aside by agreement of the parties.

Hence, Article 259(1) of the Civil Code allows the parties to exclude the obligor's liability resulting from its failure to perform its contractual obligations or from delays in performance. Such exclusion does not include liability in the event of fraud or gross fault, which cannot be excluded. Article 259(2) of the Civil Code also allows the debtor to exclude its liability for fraud or gross fault committed by those assisting it in the performance of its obligations. This provision could serve as a basis for the contractor to exclude liability for its subcontractors' fraud or gross fault.

Article 715 of the Civil Code considers as null any condition to exclude or limit the liability of the engineer or the contractor from the decennial liability.

6.2 Wilful Misconduct and Gross Negligence

The expressions "wilful misconduct" and "gross negligence" do not feature in the Civil Code, which refers to "fraud" and "gross fault" as previously mentioned in **6.1 Exclusion of Liability**.

The Civil Code does not provide for a definition of these concepts within the context of exclu-

sion of liability. Nonetheless, Article 134 of the Civil Code defines fraud in the context of defects that would vitiate consent, and considers this as occurring where consent was given as a result of manoeuvres aimed at misleading a party into contracting.

In defining the act of fraud, the Qatari Court of Cassation has set out a general definition of the concept of fraud in contracts as follows:

"[A]ny acts or methods aiming to deceive a contracting party by impairing its consent or preventing it from making a sound and informed decision. Mere lying is not sufficient to constitute fraud unless it is clearly demonstrated that the deceived party was unable to uncover the truth beyond the lie. If the deceived party could discern the truth, then fraud is not recognised."

Gross fault is not defined within the law, but is considered in civil law countries, including Qatar, as that fault which should not be made by the least cautious or the most negligent. It shows a party's failure to take the minimal care, which would have avoided such fault.

6.3 Limitation of Liability

The Civil Code recognises the parties' right to limit liability under Article 267 of the Civil Code, which states that, if the agreed compensation amount is exceeded, the creditor cannot claim compensation for the excess unless it proves fraud or gross fault by the debtor. Generally, construction contractual limitations on liability, including liquidated damages, are valid and enforceable, except for wilful misconduct and gross negligence.

7. Risk, Insurance and Securities

7.1 Indemnities

Indemnity clauses aim to compensate the indemnified party for any losses incurred as a result of the liability it may hold towards third parties following the indemnifier's default. In the context of subcontracting, the subcontractor may be required to indemnify the contractor for damages resulting from their default and which have affected the main works. These clauses play a crucial role in allocating risk and ensuring that the responsible party bears the ultimate financial burden.

7.2 Guarantees

In construction contracts, it is common to include the obligation for the contractor to provide several types of bonds to the employer as a guarantee of its contractual obligations. These typically include:

- bid bonds, which guarantee that the bidder will commit to the contract once awarded the bid;
- an advance payment guarantee, generally amounting to 10% of the contract price and guarantying recovery of the advance payment (these are generally released or reduced once the advance payment is recovered through interim payments);
- performance bonds, generally amounting to 10% of the contract price and aiming to guarantee performance (these are generally released after taking over or final completion);
- retention bonds, which may replace retention (employer's holding 5% to 10% of every payment); and
- maintenance bonds, which aim to protect employers from defects in the works.

In Qatar, bonds often take the form of "irrevocable and on-demand" letters of guarantee issued by the contractor's bank and provided for in Articles 406 to 413 of the Commercial Code. Article 409 requires the bank to pay the employer the amount of the bond upon first demand, irrespective of the status of the employer's relationship with the beneficiary.

Under Qatari law, the following are required for a valid guarantee:

- the guarantee must be in writing;
- the guarantor must be solvent and a resident of Qatar – if the guarantor becomes insolvent or leaves Qatar, the debtor must provide a new guarantor or sufficient security; and
- the guaranteed amount cannot exceed the debt, and the terms of the guarantee cannot be more burdensome than the conditions of the guaranteed debt.

The agreed terms and conditions of the guarantee will govern its validity and enforceability.

7.3 Insurance

Given the risks encountered in construction projects, insurance requirements are generally negotiated and included in the contract. The contractor is the party that is contractually required to take out and maintain insurance coverage for risks encountered during performance.

Insurance products in Qatar offer contractors coverage for a wide range of risks, including:

- workers' compensation, which includes coverage for workers' compensation and employers' liability – this insurance is essential given the provisions of labour law, which grants employees and their families com-

- pension rights in the case of work-related disability or death;
- damage to third-party property;
- loss of anticipated or potential income in the event of physical loss or damage during construction projects;
- professional indemnity; and
- fire incidents.

The scope of coverage can be negotiated between the insurer and the insured to include additional risks. However, insurance typically excludes delay damages caused by environmental hazards, such as the runoff of toxic liquids onto adjacent lands.

Architects and engineering consultancy offices licensed in Qatar are required to have a professional indemnity insurance and an indemnity coverage for their personnel and employees (Executive Regulations of Law No 19 of 2005).

Qatar has enacted the Healthcare Services Law No 22 of 2021, which includes a mandatory supplemental health insurance provision that requires employers to provide health insurance for non-Qatari employees and their families, as well as for foreign visitors, for the duration of their stay. However, this law entered partial effect on non-residents only as of the date of this publication.

7.4 Insolvency

In Qatar, two regimes are provided for in law:

- liquidation (Articles 540 to 545 of the Civil Code, and Articles 304 to 321 of the Commercial Companies Law); and
- bankruptcy (Section 6 of the Qatari Commercial Code, Article 606 et seq of a mandatory nature) – bankruptcy necessarily takes the

judicial route and can only be declared by court order.

Construction contracts usually provide for the right to terminate if the other party becomes insolvent or bankrupt, without providing a specific definition thereof.

Bankruptcy is defined as the event “where a merchant stops paying his or her commercial debts at maturity due to its disrupted financial status”. As to the requirements for a creditor to initiate bankruptcy proceedings against its debtor, such creditor should:

- hold a debt that is imminently due, payable and undisputed (even if guaranteed); and
- provide evidence of the debtor’s failure to pay.

Courts have accepted voluntary liquidation of companies (as opposed to declaring them bankrupt) upon a lawsuit filed by the shareholders due to the company’s inability to pay its debts or honour its financial obligations, or due to the failure of the company to complete its projects based on the provisions of Article 291 of the Commercial Companies Law.

7.5 Risk Sharing

Qatari law does not specifically address the allocation of risk in construction contracts. These are generally determined and agreed on in the contract through the allocation of risks between the parties, namely in the event of force majeure and unforeseen circumstances.

Failing any such stipulations, the risks that would affect the performance of the obligations, namely force majeure and extraneous events, are set out and will be deducted from the law as stated in the Civil Code (see **5.5 Force Majeure**).

Shared risks in construction contracts are generally assessed and priced based on factors such as:

- the likelihood and severity of the risk;
- project complexity;
- market conditions; and
- the bargaining power of the parties.

Pricing mechanisms may include:

- contingency allowances – funds set aside to cover unforeseen risks or events;
- risk premiums – additional compensation provided to the party assuming a higher level of risk;
- lump sum allowances – fixed amounts allocated in the contract for specific risk events or contingencies; and
- insurance and bonds – transfer of risk through insurance policies or performance bonds, where the cost of insurance premiums or bond fees may be included in the contract price.

8. Contract Administration and Claims

8.1 Personnel

Construction contracts generally include the following in relation to personnel:

- working hours and overtime, usually reflected in time sheets;
- workmen compensation insurance;
- termination provisions;
- replacement and substitution; and
- health and safety requirements.

Outside construction contracts and in relation to the relationship between the contractor and its

employees, Qatari labour law – which secures employees' basic rights – is mandatory and cannot be set aside by agreement, but can, however, be improved. This includes:

- end-of-service benefits;
- notice period;
- annual leave and sick leave;
- work-related injuries and health risks; and
- related compensation.

Construction contracts in Qatar must comply with these provisions, ensuring the protection of workers' rights and adherence to labour standards.

Qatar issued Law No 22 of 2021 regulating the health services in Qatar, with effect from 4 May 2022, and which provided basic health insurance coverage for Qatari nationals and foreigners, whether resident or visitors. This law repealed all former laws governing health services, and prescribed a minimum level of coverage with insurance companies registered with the Ministry of Public Health. As of the date of this publication, such law has been implemented for visitors of Qatar and not its nationals and residents, and is awaiting the publication of detailed implementing regulations.

8.2 Subcontracting

Article 701 Civil Code authorises contractors to subcontract all or part of the works, usually with the employer's prior approval, unless the terms of the main contract state otherwise and/or provide for nominated subcontractors, or unless, given the nature of the work, the contract was concluded *ad personam*. This Article (and the contract) stipulates, however, that the main contractor remains liable towards the employer for its subcontractor's work.

8.3 Intellectual Property

Intellectual property (IP) provisions address ownership, use and protection of IP rights in relation to the project, and, in certain cases, have specific laws and benefit from protection in Qatar (“Registration of IP rights”).

Depending on the contract, they usually include:

- copyrights (such as blueprints, project drawings, technical designs, written materials, photographs and project design);
- design patents and utility patents (protection of newly invented construction process, material, business method and/or equipment that gives its owner a competitive advantage);
- trade marks (such as joint venture names, business names and project names); and
- trade secrets (which protect the confidential business information and methods).

While the specific provisions on IP rights and IP risks may vary depending on each project, they generally include:

- ownership of design and engineering works (including architectural drawings, plans, specifications and other related documents) which will remain with the party that created them or be transferred to the employer upon completion and payment;
- use, licensing and the method of transfer of the IP right;
- confidentiality and non-disclosure clauses or other confidentiality measures to protect the corresponding rights attached to them;
- details of categories of IP that are protected, the extent of the protection and the right to use it to identify situations of infringement;
- indemnification for IP infringement; and
- a dispute resolution clause.

9. Remedies and Damages

9.1 Remedies

Articles 241 et seq of the Civil Code provide for the remedies available to a party in the case of breach of contract, and primarily set out the principle according to which an obligor should be ordered to specifically perform in the case of breach, following a notice to this effect. Compulsory performance can only be sought through a court judgment following a lawsuit before the competent judge.

Where the obligation requires the performance of a service, Article 251 of the Civil Code authorises the creditor to seek a court order to have the obligation performed by a third party at the obligor’s cost, except in emergency cases where the creditor is exempted from obtaining such court order.

If, given its nature, the obligation cannot be performed in nature, or if the obligor is in delay regarding performance, the creditor may request compensation for actual losses incurred as a result of the delay or non-performance (Article 256 of the Civil Code).

The creditor may also request termination in the event of breach, or where the other party fails to perform its reciprocal obligation under specific conditions set out by the law or in the contract (see 9.6 Termination).

For a party to be able to enforce any of the above-mentioned remedies, it is required to obtain a final judgment from the substantive competent court, unless the contract expressly provides for the right to terminate without the interference of the court.

If urgent measures are required, a party may also apply to the emergency judge for an interim measure of protection in order to prevent or resist an imminent danger. The requirements for such application are strict in that the applicant should prove an imminent danger to property or livelihood, and as such it can only be granted in restrictive cases.

Subcontractors are granted the right of direct recourse against the employer if the contractor fails to honour its payment obligations of amounts due to the subcontractor, within the limits of the value of any debts the employer owes the contractor at the date of the initiation of the lawsuit (Article 702 Civil Code).

9.2 Restricting Remedies

Articles 265 to 267 of the Civil Code allow parties to agree on monetary compensation for delayed or non-performance, provided the underlying obligation is non-monetary. However, if the debtor can prove that no losses were suffered, the agreed compensation does not become due and payable. The judge also has the authority to reduce the agreed compensation if it is deemed excessive or if partial performance has occurred.

Under Article 267 of the Civil Code, the employer is prohibited from seeking a higher compensation if actual damages exceed the agreed amount, making the agreed compensation the sole remedy for damages resulting from non- or delayed performance. However, this does not apply if the creditor proves fraud or gross fault by the debtor.

Article 259 of the Civil Code allows clauses that limit or exclude liability, except in cases of gross fault or fraud. While liquidated damages may be the exclusive remedy for delay-related losses, the employer can still seek compensation under

the Civil Code for other breaches, unless the contract explicitly excludes it.

9.3 Sole Remedy Clauses

To the extent that liability can be excluded or limited contractually under Qatari law, exclusive remedy clauses may be enforced (see 5.2 Delays and 6. Liability).

9.4 Excluded Damages

Liability for damages may be excluded to the extent it does not relate to fraud, gross fault or illegitimate acts under Qatari law. Exclusions may include direct damage, lost profit or other moral damages (see 6.1 Exclusion of Liability).

9.5 Retention and Suspension Rights

Retention and suspension rights are commonly used to provide the employer with recourse in the case of defective work, non-performance or other breaches by the contractor. These are not prohibited under Qatari law.

Generally, contracts grant the employer the right to withhold 10% of the contract price until a specified time. Out of this amount, 5% is released to the contractor upon completion, while the remaining 5% is released at the conclusion of the defect liability period.

Unless agreed otherwise, Article 191 of the Civil Code enshrines the civil law principle of *exceptio non adimpleti contractus*, according to which a party may suspend performance if the other party fails to perform its reciprocal obligation. For a party to avail itself of this principle, the opposing party should have failed to perform an obligation that is immediately due and that is considered reciprocally linked to the obligation it wishes to suspend.

9.6 Termination

Under Qatari law, unless otherwise expressly stated in the contract, termination can only be achieved through a court order.

Under Articles 707, 183 and 184 of the Civil Code, a construction contract can be terminated either fully or partially for convenience (termination at will) due to default or impossibility to perform:

- in the case of termination at will, the employer is obligated to compensate the contractor for incurred costs, completed works and lost profit (Article 707(1) of the Civil Code);
- in bilateral contracts, if one party fails to fulfil a fundamental obligation, the other party has the right to demand performance of the contract or its termination (Article 183);
- if the performance of obligations becomes impossible due to reasons beyond the control of the parties, the contractor is entitled to demand compensation for incurred costs and earned fees, up to the limit of the employer's benefit (Article 171(1) of the Civil Code);
- the employer has the right to request termination of the contract or completion at the contractor's expense if the contractor fails to perform the works in accordance with the contract terms, despite being notified (Article 688); and
- the employer has the right to terminate the contract if the contractor is delayed in fulfilling its obligations to such an extent that it becomes impossible to complete the work within the agreed timeframe, or if the contractor demonstrates an intention to not perform (Article 689).

The contractor has the right to terminate the contract and demand compensation if the employer, despite being notified, fails to take necessary

actions required for the progress of the works (Article 692 of the Civil Code).

10. Dispute Resolution

10.1 Regular Dispute Resolution

The following institutions are competent to adjudicate disputes:

The newly established Trade and Investment Court (Law of 21 of 2021) (first instance, appeal and cassation) is competent.

The civil and commercial courts (administrative circuit) retain jurisdiction for disputes relating to construction contracts of an administrative nature. A circuit is also established within the Court of Appeal for arbitration-related applications (arbitrator's appointments, challenges, setting aside awards).

The Qatar International Court and Dispute Resolution Centre of the Qatar Financial Centre (QICDRC), which is an onshore Qatari jurisdiction, retains competence over disputes between companies established within the QFC (as per the provisions of Article 9 of the QFC Court's Regulations) as well as over disputes within and against the Qatar Free Zone Authority (QFZA). The QICDRC is competent in arbitration-related matters where the parties have chosen the QFC as the seat of arbitration or have chosen this court as the competent court under Arbitration Law No 2/2017.

The Claim and Compensation Committee (CCC) established in 1996 (with subsequent multiple legislative amendments, most recently in 2020) under the Ministry of Finance reviews compensation applications by contractors arising from construction contracts and involving a govern-

ment entity whose decisions are not legally binding nor published. The contractor has the option to accept the decision or to seek a court judgment or arbitral award depending on the dispute resolution agreement.

The new Enforcement Court was established by virtue of Law No (4) of 2024 issued on 4 April 2024 and promulgating the Judicial Enforcement Law. The new law incorporates legislative measures intended to be effective to expedite the enforcement of judgments and executory deeds. The new law expressly grants cheques the power of executive instruments, enabling beneficiaries to collect amounts in cases of insufficient funds. It also grants registered or authenticated property lease contracts executive authority regarding property evacuation post-contract, in both cases without initiating primary substantive legal proceedings. Finally, it grants the enforcement judge the power to accelerate the enforcement proceeding and to impose penalties in the case of obstruction of enforcement.

10.2 Alternative Dispute Resolution

Mediation is an optional procedure that parties can choose for resolving their disputes, as there are no legal limitations preventing its use. It can be found as a pre-arbitration step in certain dispute resolution clauses included in construction contracts in Qatar.

Law No 20 of 2021, on Mediation for the Settlement of Civil and Commercial Disputes, was issued on 18 October 2021, to regulate mediation agreements; already on 12 September 2020, Qatar ratified the Singapore Convention on Mediation, which aims to facilitate the recognition and enforcement of mediation settlements.

The QICDRC provides for mediation services through its mediation rules, while the Qatar International Conciliation and Arbitration Centre (QICCA) offers conciliation services through its rules issued in 2012.

Arbitration agreements pertaining to private contacts or administrative and public contracts are recognised under Law No 2 of 2017 – which applies to arbitrations seated in Qatar or to the recognition and enforcement proceedings of foreign awards in Qatar, provided they do not contravene Qatari public policy or morals (Article 28). For administrative contracts, the approval of the Prime Minister (or his designated delegate) is required.

Trends and Developments

Contributed by:

Claudia El Hage, Amale El Baba and Danah Mohamed
Al Marri & El Hage Law Office

Al Marri & El Hage Law Office (MHLO) has a diverse team of specialised lawyers that provides legal consultancy and represents international or local firms and institutions in litigation (before the state courts and QICDRC), including in arbitration, mediation, alternative dispute resolution proceedings and all related procedures, in Qatar or abroad (Saudi Arabia, UAE, Oman, Lebanon, Iraq, Jordan, France, the UK, Greece,

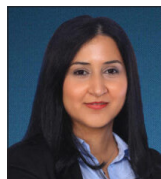
Italy, Spain and Singapore). MHLO is a fully fledged office that provides professional legal services in various areas of the law and on a wide variety of issues. MHLO has been recognised by Chambers and Partners Middle East as Qatar Law Firm for three consecutive years (2022, 2023 and 2024), and for its strengths in international arbitration as a diligent and effective law firm.

Authors



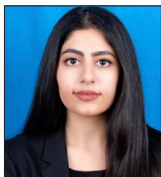
Claudia El Hage is a managing partner at MHLO and acts as a legal consultant, litigator, arbitrator and legal expert on civil law. She mainly specialises in construction, contracting,

engineering consultancy, property and real estate, corporate, banking and M&A. She advises international and local firms on their projects, with a focus on the MENA region and Europe. She has advised and represented clients in litigation, ADR, compliance, regulatory investigations and annulment recourses in relation to various disputes and transactions. Claudia also advises on corporate and commercial matters, as well as in business criminal cases and regulatory investigations. Her practice provides essential legal counsel to many international, regional and local companies and corporations.



Amale El Baba is head of the litigation department at MHLO and acts in litigation, arbitration and legal consultancies. She represents various local and international clients, and works

mostly in litigation and arbitration concerning civil and commercial matters in different industries (mainly construction, banking and insurance). She also handles regulatory and compliance investigations. Amale has extensive and comprehensive experience of the Qatari and regional market, and provides legal advice on all queries and risks pertaining to civil and commercial laws, in dispute resolution cases and regarding compliance with regulations and corporate governance requirements. She has acted before the QICDRC and in various institutional arbitration and regulatory investigation cases.



Danah Mohamed is a lawyer at MHLO whose practice covers multiple areas, including litigation and arbitration in civil and commercial disputes (domestic and international),

construction, banking, fintech and employment/labour disputes, and land and property matters. She has provided comprehensive legal opinions to various regional and international entities, and has been involved in institutional arbitrations under the expedited rules and the standard rules. She has also successfully represented clients in various litigation cases before the state courts and the QICRDC, including handling pro bono cases.

Al Marri & El Hage Law Office

Grand Hamad Street 810
Al Fardan Center Building 36, Floor 3
Old Ghanim 6
Qatar

Tel: +974 444 306 51
Email: admin@marri-hage.com
Web: www.marrilaw.com



المري و الحاج
AL MARRI & EL HAGE
LAW OFFICE مكتب محاماة
QATAR | LEBANON

After the World Cup 2022, Qatar saw and continues to experience a dynamic transformation, with new construction projects being introduced and a drive towards digitalisation and sustainable development. Qatar is also witnessing several developments aimed at enhancing the justice system. This article explores several key legislative reforms, in addition to legal developments and socio-economic trends within the construction industry.

Law No 4 of 2024: the “Judicial Enforcement Law”

The introduction of Law No 4 of 2024, known as the Judicial Enforcement Law, is a significant development and has been designed to enhance the justice system with a focus on digital transformation and on expediting litigation processes.

Notable provisions of this law include the granting of executive power to cheques, aimed at combating financial crimes such as dishonoured cheques. This addition to the legal framework could enhance financial stability within the industry and provide companies with a more robust mechanism to address financial disputes.

Through this law, a specialised court will be established, dedicated to the enforcement of judicial decisions and expected to enhance the efficiency of legal proceedings, resulting in quicker resolution of disputes. This is particularly crucial in an industry where timely resolution of conflicts can significantly affect costs and project timelines.

Law No 8 of 2023: the “Judicial Authority Law”

In May 2023, Qatar issued Law No 8 of 2023, promulgating the Judicial Authority Law. This replaces Law No 10 of 2003, establishing the

“General Authority of the Court” within the Court of Cassation, and tasked with:

- adjudicating jurisdictional conflicts;
- approving and unifying legal principles; and
- addressing matters referred by the Supreme Judicial Council.

It also permits electronic judicial procedures, including trials and witness hearings, following specified guidelines set by the Council.

Law No 11 of 2022 Amending Provisions of the Income Tax Law

The amended Tax Law No 11 of 2022 introduces multiple changes to tax exemption eligibility. Private associations, foundations, charitable organisations and foundations of public interest (previously excluded from the Income Tax Law per Article 2 of Law No 24 of 2018) are now included. These entities enjoy tax-exempt status under Article 4 of the Tax Law, with requisite tax-related obligations such as registration and filing of tax returns.

The revised regulations also include a provision regarding dividends paid to Qatari projects for their operations outside Qatar. Such dividends may be exempt from taxation in Qatar, contingent upon equivalent business outcomes being taxed in the foreign jurisdiction.

Awarding of Prolongation Costs in Construction Projects by Qatari Courts

There has been a positive shift in the courts’ approach regarding prolongation costs in construction disputes. Previously, courts were hesitant to grant such costs and would cap awards at the contract price, regardless of contractual agreements. Recent developments indicate a more pragmatic approach, with courts showing a greater willingness to consider and compen-

sate for project delays as well as encouraging greater compliance with contractual terms within the construction industry.

Mediation

There is a trend towards alternative dispute resolution by parties in contracts, especially within multi-tier dispute resolution clauses. Mediation is encouraged to be adopted by parties, as it provides a more cost-effective and time-efficient alternative to formal legal proceedings and for parties keen on preserving their business relationships, particularly after the introduction of the new mediation law (No 20 of 2021).

The Qatar International Court and Dispute Resolution Centre (QICDRC) also has a mediation panel that offers its services to individuals and businesses, regardless of their location, whether within Qatar or abroad. Qatar was one of the first countries to ratify the United Nations Convention on International Settlement Agreements Resulting from Mediation, which further emphasises its dedication to promoting mediation as a dispute resolution mechanism.

Socio-Economic Trends

Turning to developments within the construction industry itself, Qatar has been undergoing a post-World Cup shift since 2022, largely driven by the global wave of digital transformation and sustainability. This transformation is beginning to reshape how projects are planned, executed and managed, in alignment with Qatar's National Vision of 2030.

Artificial intelligence and digital transformation

One significant aspect of these developments is the integration of digital technologies and artificial intelligence (AI). Qatar has made substantial investments in AI, with projections indicating

significant growth in its impact across strategic sectors (including construction), and with initiatives such as the National Artificial Intelligence Strategy and the establishment of the Artificial Intelligence Committee. The new laws being introduced, including the Judicial Enforcement Law, are also starting to address electronic linkage, data digitisation and the leveraging of AI technologies.

According to the Ministry of Transport and Communication's reports, the AI market size in Qatar was estimated at USD31 million in 2022, with an expected annual growth rate of 17.4%. By 2026, it is expected to reach USD58.8 million. Notably, the construction, energy and public sectors are projected to be the most significantly impacted by AI, and they hold strategic importance for Qatar.

The Ministry recently unveiled Qatar's National Artificial Intelligence Strategy. This strategy is built on six key pillars:

- education;
- data access;
- employment;
- business;
- research; and
- ethics.

This has the aim of steering Qatar towards a future driven by AI. In line with this strategy, an Artificial Intelligence Committee has been established within the Ministry of Communications and Information Technology, by Cabinet Decision No 10 of 2021. The Committee, comprising representatives from various entities (including the Ministry of Interior, the Ministry of Commerce and Industry, and the Qatar National Research Fund) is tasked with overseeing the implementation of Qatar's AI initiatives.

Further, the Ministry launched the Digital Agenda 2030 aimed at fostering growth and development opportunities, with projections indicating the generation of QAR40 billion in economic output and the creation of 26,000 jobs by 2030. Comprising 23 strategic programmes, the Digital Agenda 2030 is structured around six core pillars:

- digital infrastructure;
- digital government;
- digital technologies;
- digital innovation;
- digital economy; and
- digital society.

Moreover, the Investment Promotion Agency Qatar (Invest Qatar) revealed a collaborative report with the Ministry of Communications and Information Technology titled “Smarter Qatar: Embracing Emerging Technologies and Innovation, Improving Lives, and Driving a Sustainable Digital Economy”. This report highlights initiatives aimed at seizing opportunities in the expanding global smart city market, which is expected to reach nearly USD7 trillion by 2030.

Given these developments, the National Cyber Security Agency has created guidelines governing the usage of AI both in public and private organisations in Qatar. These guidelines are applicable to entities currently utilising AI systems, services or products, or to those intending to deploy them.

Specifically, the guidelines address three major dimensions where cybersecurity intersects with AI.

Cybersecurity of AI

This dimension involves assessing and managing the information security risks associated

with AI systems. It encompasses evaluating the security of various components, including:

- the application (front-end, back-end, data-bases);
- the underlying infrastructure (hardware and network); and
- the underlying AI models and algorithms.

AI in supporting cybersecurity

AI is utilised as a tool to enhance cybersecurity efforts, creating advanced tools for tasks such as threat detection, behavioural analysis, predictive analysis and response speed. These AI-driven cybersecurity tools augment traditional security measures and increase organisations’ defences against evolving threats.

Malicious use of AI

This dimension addresses the adversarial use of AI by malicious actors to perpetrate sophisticated cyber-attacks. Threat actors may leverage AI to orchestrate targeted attacks, manipulate data or breach security defences. Understanding and mitigating the risks associated with malicious AI usage is now even more important for safeguarding organisations’ digital assets and operations.

These guidelines are particularly important for contractors and construction companies, as major construction projects involve the collection, processing and storage of vast amounts of sensitive data. Implementing measures outlined by the National Cyber Security Agency would thus help companies demonstrate due diligence in safeguarding sensitive data and in mitigating cybersecurity risks, to reduce their exposure to potential legal liabilities.

The integration of new technologies such as AI into construction processes could bring

an increased risk of data breaches, particularly where companies have not acquired a full understanding of their duties and responsibilities under the Qatari data protection laws (breaches of which can be investigated by the Cybercrime Department of the Qatari Public Prosecution). The guidelines thus aim to address these risks by providing recommendations for securing AI systems and protecting sensitive construction data from unauthorised access, cybercrimes or exploitation.

Environmental sustainability

In parallel with the foregoing, Qatar is also focusing on environmental sustainability, as evident by its initiatives; Qatari courts have now almost fully transitioned to paperless operations with the updated electronic case management system. This also aligns with the state's commitment to reducing environmental impacts and embracing digital transformation across sectors.

The recent developments of projects such as Msheireb Downtown Doha and Lusail City are also seen as aligning with Qatar's 2030 vision for a sustainable future, with the integration of smart technologies and energy-efficient practices.

The Public Works Authority (Ashghal) is promoting sustainability and material recycling as a goal within its corporate strategy. It has launched multiple initiatives, programmes and systems aimed at fostering environmental sustainability across all project stakeholders, including consulting firms, contractors, suppliers and workers. Such efforts are designed to create a culture of environmental responsibility and innovation, and the implementation of new methods throughout various project stages.

In pursuit of its commitment to environmental sustainability, Ashghal has focused on recycling

materials used in construction, with over 11 million tonnes of recycled materials being incorporated into projects, representing a significant contribution to environmental conservation.

To enhance environmental performance monitoring, Ashghal introduced its Environment and Sustainability Monthly Report in 2019. This innovative tool enables accurate monitoring and reporting of construction materials and carbon emissions, to facilitate informed decision-making and accountability. Notably, this approach has led to a substantial reduction in carbon emissions from Ashghal's Roads Projects Department endeavours in 2023.

Furthermore, Ashghal has strategically established three construction material recycling zones across Doha, to optimise resource efficiency. These facilities process and recycle construction waste materials (such as excavated material, reclaimed asphalt, concrete and demolition waste), mitigating the need for landfill disposal and reducing carbon emissions associated with transportation and material sourcing. It has made efforts in renewable energy integration by establishing the largest solar-powered electric charging station in the region.

Future projects

Amid Qatar's ambitious National Vision 2030 objectives, an array of new projects and initiatives are underway: the Qatari government has launched the Transportation Master Plan for Qatar 2050 (TMPQ), which serves as a strategic roadmap for investing in land transportation infrastructure. It outlines the frameworks and future directions for the development of transportation networks across the country, and encompasses a range of initiatives and projects that cater to users of land transportation systems and networks up until 2050.

The TMPQ strives to strike a balance between the requirements of economic growth and environmental protection, thereby contributing to the reduction of climate change. There are also economic benefits to the plan, including:

- increased revenues;
- reduced vehicle-operating costs;
- energy conservation;
- shorter travel times; and
- decreased carbon emissions.

This plan includes the development of over 60 national land transportation policies, which will further enhance the transportation services provided in Qatar. The TMPQ also presents schemes and projects that involve the development of:

- road networks;
- public transportation;
- transportation services management;
- laws and governance; and
- transportation technologies.

The plan also includes the expansion of the main road network through 37 proposed projects, and the development of the main public transit network through 30 projects. Through the implementation of these plans and projects, the TMPQ aims to establish a sustainable transportation system that supports both the environment and the economy.

The construction industry in Qatar also continues to undergo significant transformations to prepare for the 2030 Asian Games. The infrastructure projects associated with the Asian Games include creating facilities that can be repurposed and utilised for various purposes in the long-term. This strategic approach ensures that the investments made will continue to ben-

efit the country and its residents beyond the conclusion of these events.

Investments in infrastructure development are therefore expected to have a positive effect on the economy. The construction industry is expected to generate more employment opportunities, stimulate local businesses and attract foreign investment.

At this stage, the construction sector is expected to continue to expand under future projects, with plans to initiate projects worth QAR70 billion (USD19.2 billion) in 2024. These projects, launched by entities such as Ashghal and the Qatar General Electricity and Water Corporation (Kahramaa), encompass various sectors, including infrastructure development, road connectivity and sewage projects (among others).

With Ashghal planning approximately 116 public tenders valued at around QAR59 billion (USD16.2 billion) in 2024 alone, construction companies can expect increased demand for their services across a wide range of project types. These include:

- developing existing and new lands;
- connecting and improving roads;
- projects for sewage and marine outfalls;
- maintaining road networks and sewage;
- beautification of roads, public places, highways and public buildings; and
- operational public procurement.

Furthermore, Kahramaa's allocation of QAR8.9 billion (USD2.4 billion) for 279 tenders in areas such as electricity networks, water networks and service departments underscores the range of opportunities available within the construction sector.

Sector-wise, the distribution of tenders highlights key areas of focus, with significant investments planned for electricity networks, water networks and service departments. This diversification presents companies with the chance to participate in projects aligned with their expertise and capabilities.

Meanwhile, the value of the 279 public tenders offered by Kahramaa for 2024 amounts to about QAR8.9 billion (USD2.4 billion) in three areas – ie, the electricity networks sector, the water networks sector and the corporations' service departments sector.

The Director of Government Procurement Regulations has also provided insight into the distribution of tenders, revealing that approximately 85% of tenders are concentrated within five primary economic sectors, with the construction sector including 360 tenders.

With these developments and initiatives, Qatar appears to be making progress towards its National Vision 2030. The legal and construction landscape appears particularly promising, given the country's efforts to commit to modernisation and sustainable development, and to adapt to evolving technologies.

SAUDI ARABIA



Law and Practice

Contributed by:

Alex Saleh, Mohammad Nader Al Awadhi, Rana Moustafa and Shahad Al-Humaidani
GLA & Company

Contents

1. General p.528

- 1.1 Governing Law p.528
- 1.2 Standard Contracts p.528

2. Parties p.528

- 2.1 The Employer p.528
- 2.2 The Contractor p.529
- 2.3 The Subcontractors p.529
- 2.4 The Financiers p.529
- 2.5 The Designer p.530

3. Works p.531

- 3.1 Scope p.531
- 3.2 Variations p.531
- 3.3 Design p.531
- 3.4 Construction p.532
- 3.5 Site p.533
- 3.6 Permits p.533
- 3.7 Maintenance p.533
- 3.8 Other Functions p.533
- 3.9 Tests p.533
- 3.10 Completion, Takeover and Delivery p.534
- 3.11 Defects and Defects Liability Period p.534

4. Price p.534

- 4.1 Contract Price p.534
- 4.2 Indexation p.535
- 4.3 Payment p.535
- 4.4 Invoicing p.535

5. Time p.535

- 5.1 Planning and Programme p.535
- 5.2 Delays p.535
- 5.3 Remedies in the Event of Delays p.536
- 5.4 Extension of Time p.536
- 5.5 Force Majeure p.536
- 5.6 Unforeseen Circumstances p.537
- 5.7 Disruption p.537

6. Liability p.538

- 6.1 Exclusion of Liability p.538
- 6.2 Wilful Misconduct and Gross Negligence p.538
- 6.3 Limitation of Liability p.538

7. Risk, Insurance and Securities p.538

- 7.1 Indemnities p.538
- 7.2 Guarantees p.539
- 7.3 Insurance p.540
- 7.4 Insolvency p.540
- 7.5 Risk Sharing p.540

8. Contract Administration and Claims p.541

- 8.1 Personnel p.541
- 8.2 Subcontracting p.541
- 8.3 Intellectual Property p.542

9. Remedies and Damages p.542

- 9.1 Remedies p.542
- 9.2 Restricting Remedies p.543
- 9.3 Sole Remedy Clauses p.544
- 9.4 Excluded Damages p.545
- 9.5 Retention and Suspension Rights p.546
- 9.6 Termination p.546

10. Dispute Resolution p.547

- 10.1 Regular Dispute Resolution p.547
- 10.2 Alternative Dispute Resolution p.547

Contributed by: Alex Saleh, Mohammad Nader Al Awadhi, Rana Moustafa and Shahad Al-Humaidani, GLA & Company

GLA & Company is a regional law firm based in the United Arab Emirates (UAE), providing strategic, cost-effective and forward-thinking legal representation for companies seeking to do business in the Middle East. The firm is proud to hold a diverse portfolio of clients, from start-ups to global enterprises. GLA's practice consists of a full-service law firm, from simple advisory work to complex contentious and non-contentious matters.

With extensive experience in advising clients in the key Gulf Cooperation Council (GCC) states of Kuwait, Saudi Arabia, Qatar, the UAE, Egypt and Lebanon, the firm offers unique insights for companies seeking quality legal services. Data protection and privacy is an area of special attention for the firm, considering the expansion and revamping of applicable laws and regulations across the GCC.

Authors



Alex Saleh is a founder and managing partner of GLA & Company, and takes a leading regional role in the firm concerning its M&A and private equity practice. With over 25

years of experience both in the Gulf Cooperation Council and in the USA, he has accumulated considerable expertise in the areas of banking and finance, M&A, capital market deals and infrastructure projects. His experience garners praise from leading legal directories, and his transactions regularly win Deals of the Year from such institutions and organisations.



Mohammad Nader Al Awadhi is a corporate and commercial lawyer, as well as a commercial and civil litigator, representing multinational companies and joint ventures in connection with

litigation and possible litigation strategies. He also regularly leads and assists GLA & Company's corporate team in the Kuwait office with their day-to-day matters, with a primary focus on legal issues arising from corporate affairs in Kuwait. Mohammed prides himself in leading the firm on acquisitions in all sectors of the Kuwait and regional market.

Contributed by: Alex Saleh, Mohammad Nader Al Awadhi, Rana Moustafa and Shahad Al-Humaidani, GLA & Company



Rana Moustafa is an associate at GLA & Company with extensive experience in international and domestic commercial disputes, spanning the Gulf Cooperation Council and Europe. She has represented clients in Kuwait, Lebanon, Qatar, the UAE, Saudi Arabia, Egypt and France. She has experience in international and domestic arbitration, working on matters held under the auspices of the ICC, DIFC-LCIA, CRCICA, DIAC, ICSID and CAS. Rana increased her experience in data protection while working on matters related to data protection disputes, data protection frameworks at the workplace and data protection policies for clients. She is a member of the Egypt Bar Association and is currently studying for the French Barreaux.

Shahad Al-Humaidani serves as an associate at GLA & Company's Riyadh office, and has a versatile background in governmental and private sectors within Saudi Arabia. Her expertise is particularly focused on providing support to foreign companies aiming to establish a presence in the Kingdom of Saudi Arabia (KSA). In this capacity, she navigates the complexities of regulatory frameworks, including the Saudi Arabian General Investment Authority (MISA) and the Ministry of Commerce (MOC). Shahad's keen understanding of the legal landscape ensures the smooth entry of foreign entities into the KSA market, guaranteeing compliance with local regulations and facilitating successful business operations.

GLA & Company

Alex Saleh
Managing Partner

Tel: Kuwait +965 669 55516/UAE +971 54 997 4040
Email: alex.saleh@glaco.com
Web: www.glaco.com/attorneys/alex-saleh



1. General

1.1 Governing Law

The two major pieces of legislation that govern the construction law industry are the New Civil Transactions Law (NCTL) and the Saudi Building Code (SBC).

The NCTL was enacted by Royal Decree No M/191 of 2023.

The SBC (enacted by Royal Decree No M/43 of 2017 and amended by Royal Decree M/15 of 2019) and its implementing regulations play a crucial role in regulating the construction industry, and aim to streamline the execution of construction projects in Saudi Arabia. The SBC helps regulate the safety, efficiency and sustainability of buildings in the Kingdom.

1.2 Standard Contracts

In practice, the most common construction contracts used in Saudi Arabia stem from the International Federation of Consulting Engineers (FIDIC). The predominant forms are the first editions (published in 1999) of the following:

- Conditions of Contract for Construction for Building and Engineering Works Designed by the Employer (also known as the Construction Contract or the “Red Book”);
- Conditions of Contract for Plant and Design-Build for Electrical and Mechanical Plant and for Building and Engineering Works Designed by the Contractor (also known as the Plant and Design-Build Contract or the “Yellow Book”); and
- Conditions of Contract for EPC/Turnkey Projects (also known as the EPC/Turnkey Contract or the “Silver Book”).

It is common for FIDIC contracts to be modified, often in favour of the employer. Such redistribution of risk can be extensive. The engineer’s role in the FIDIC Red Book form is often limited; as such, the employer’s approval is needed for many important decisions.

While standard contracts are used, as with any standard forms, governing rules are critical for properly negotiating, analysing and applying contractual rights and obligations. Thus, it is always advisable to seek counsel in the jurisdiction of governance, in addition to counsel in the jurisdiction where the parties are domiciled and where the project will be executed.

2. Parties

2.1 The Employer

The employer would usually be:

- a state entity;
- a company owned by the state; or
- a local entity.

The employer’s obligations encompass a range of responsibilities and duties that employers must fulfil, in order to ensure compliance with legal requirements and to promote a safe and productive work environment. Employers also have obligations related to the administration of contracts, and to the proper understanding of and compliance with contractual obligations. Disputes can, and often do, result from:

- failure to administer the contract correctly;
- poorly drafted or incomplete claims;
- errors or omissions in contract documents; and
- incomplete design information or employer requirements.

Contributed by: Alex Saleh, Mohammad Nader Al Awadhi, Rana Moustafa and Shahad Al-Humaidani, GLA & Company

Employers must do their best to understand and fulfil their contractual obligations, in order to mitigate or avoid potential legal issues.

In addition to obligations stipulated in the contract, the employer has statutory rights and obligations, such as:

- to issue acceptance certificates;
- to fulfil payment obligations;
- to agree to additional work and changes; and
- to reasonably remunerate the contractor.

The employer also has the right to cancel the construction contract.

2.2 The Contractor

The contractor's basic obligations include the obligation to perform the work in accordance with their agreement with the employer, including doing so within the agreed timeframe and in a manner consistent with the contract specifications.

As with the employer, the contractor is subject to statutory rights and obligations that may not be covered in the contract. For example, the contractor has a duty of care to perform the agreed work and to guarantee the work completed by them.

The NCTL stipulates that, during the progress of the work, if it appears that the contractor is performing the work in a defective manner or in breach of the contract, the employer may notify the contractor to correct the method of performance within such reasonable time as determined by the employer. Where such period expires without remedy of such breach, the employer may demand termination of the contract or ask another contractor to perform the

work at the cost of the first contractor, under the provisions of Article 167 of the NCTL.

If the contractor delays in commencing or accomplishing the work to such an extent that they cannot possibly deliver the work within the agreed period, or if their actions indicate their intention to not fulfil their obligations or make the performance of their obligations impossible, the employer may demand the immediate termination of the contract.

2.3 The Subcontractors

Subcontracting is allowed if mentioned in the main contract. Given the size of the projects and the specialised work required, outsourcing is very common, especially in specialised areas such as:

- design/engineering;
- enabling and foundation work;
- mechanical, electrical and plumbing work;
- facade work; and
- any special systems-required project.

The contractor may assign the implementation of all or part of the work to a subcontractor, unless the legal texts, the agreement or the nature of the work require otherwise. The responsibility of the contractor remains against the employer. In this case, the subcontractor may not claim for themselves any rights or obligations entitled to the main contractor (Articles 473–474 of the NCTL).

2.4 The Financiers

Historically, Saudi Arabia's governmental projects have been self-funded, and recent budget announcements confirm continued investment in infrastructure and construction projects. The Public Investment Fund (PIF) has a world-class investment portfolio that focuses on sustainable investments both domestically and internation-

Contributed by: Alex Saleh, Mohammad Nader Al Awadhi, Rana Moustafa and Shahad Al-Humaidani, GLA & Company

ally. With effective and long-term investments, the PIF seeks to be a leading investor and to have an impact beyond the borders of the Kingdom of Saudi Arabia (KSA). This investment strategy is consistent with Vision 2030, which will lead the transformation of KSA's economy through active long-term investments and high standards of governance and transparency.

2.5 The Designer

In Saudi Arabia's construction industry, the designer is usually a foreign company or foreign contractor overlooking the project's specifics and design changes.

Various types of companies and institutions can act as designers in construction projects in Saudi Arabia, including the following.

Architectural Firms

Firms specialising in architectural design play a crucial role in designing the overall layout, aesthetics and functionality of buildings.

Engineering Firms

Engineering companies provide expertise in various fields (such as structural, mechanical, electrical and civil engineering), contributing to the technical aspects of the project design.

Design-and-Build Firms

These firms offer integrated services encompassing both design and construction, providing a streamlined approach to project delivery.

Consulting Firms

Consulting companies may offer specialised expertise in specific areas, such as environmental impact assessment, urban planning or interior design.

Government Agencies

In some cases, government entities may directly undertake design work for public infrastructure projects.

In general, the rights and obligations of the designer under a construction contract in Saudi Arabia are governed by the terms of the contract, as well as by relevant laws and regulations. Some common rights and obligations of the designer may include the following.

Rights:

- the right to be compensated for their design services as per the terms of the contract;
- the right to have their design work accurately interpreted and implemented by the contractor; and
- the right to enforce contract provisions related to intellectual property rights and ownership of design documents.

Obligations:

- the obligation to perform design work with due care, skill and diligence in accordance with professional standards and industry best practices;
- the obligation to deliver design documents and specifications within agreed-upon timeframes; and
- the obligation to co-ordinate with other project stakeholders, such as the employer and the contractor, to ensure the successful execution of the project.

The relationship between the designer, the employer and the contractor in Saudi Arabia can vary depending on the contractual arrangements and project delivery method. However, in general:

- the designer typically enters into a contract with the employer (client) to provide design services for the project;
- the designer collaborates closely with the employer to understand their requirements and preferences, translating them into design solutions;
- once the design is finalised, the designer may work alongside the contractor during the construction phase to provide clarifications, address design-related issues and ensure that the project is built according to the design's intent; and
- while the designer may have a direct contractual relationship with the employer, they also have a professional responsibility to co-operate with the contractor to facilitate the successful completion of the project.

3. Works

3.1 Scope

In general, the scope of works in a construction contract in Saudi Arabia is determined through a combination of documents, including the programme of requirements, specifications and other project documents.

The programme of requirements outlines the client's objectives, needs, and preferences for the project.

Specifications detail the technical requirements, materials and standards to be followed in the construction process.

Additionally, drawings, plans and schedules may be used to further describe and illustrate the scope of works, providing a comprehensive understanding of the project's requirements and deliverables.

3.2 Variations

In Saudi Arabia, the scope and price for variations requested by the employer are typically determined through the contract terms, which may include provisions outlining the process for evaluating and pricing variations based on agreed-upon rates or pricing mechanisms. The contract may also specify limitations on the scope and cost of variations to ensure that they are reasonable and within the project's budget.

If a variation is requested by the contractor, the scope and price are generally subject to negotiation between the parties, with the contractor submitting proposals detailing the proposed changes and associated costs. The contract may specify procedures for assessing and approving contractor-initiated variations, as well as mechanisms for resolving disputes related to scope or pricing disagreements.

Time-related costs associated with variations are typically dealt with through the contract's provisions on extensions of time and delay-related costs. The contract may specify procedures for assessing the impact of variations on the project schedule, and for determining any resulting time extensions and associated costs. Additionally, the parties may negotiate compensation for delay-related costs resulting from variations, such as additional overhead, prolongation costs or acceleration expenses.

3.3 Design

In Saudi Arabia, responsibilities for the design process are typically divided between the employer, designer, contractor and other parties.

The employer defines project objectives and approves designs, while the designer develops the concept and ensures compliance.

Contributed by: Alex Saleh, Mohammad Nader Al Awadhi, Rana Moustafa and Shahad Al-Humaidani, GLA & Company

The contractor implements the design during construction, collaborating with the designer to address any issues.

Consultants and subcontractors may also play specialised roles in the design process. The specific division of responsibilities varies based on project requirements and contractual arrangements. Effective co-ordination between all parties is crucial for successful project delivery.

3.4 Construction

In Saudi Arabia, responsibilities for the construction process are typically divided between the employer, contractor, subcontractors and other parties involved. The following is a breakdown of the possible divisions of work.

The employer (client):

- defines project requirements, objectives and specifications;
- provides necessary permits, approvals and access to the construction site;
- ensures compliance with regulatory requirements and standards; and
- may engage consultants or specialists for project oversight, inspections or quality assurance.

The contractor:

- oversees and manages the construction process, including scheduling, co-ordination and execution of the work;
- provides labour, equipment and materials necessary for construction;
- ensures compliance with design specifications, quality standards and safety regulations; and

- manages subcontractors and co-ordinates their work to ensure timely completion of the project.

Subcontractors:

- execute specific portions of the construction work as subcontracted by the main contractor; and
- provide specialised services, such as electrical, plumbing, HVAC or finishing works.

Consultants:

- provide technical expertise and support during the construction process, particularly in specialised areas such as structural engineering or mechanical, electrical or architectural design;
- conduct inspections, quality control checks and compliance assessments to ensure adherence to design and regulatory requirements; and
- provide guidance and recommendations to the employer and contractor regarding construction-related issues or changes.

Suppliers and vendors:

- supply construction materials, equipment and components as required for the project;
- co-ordinate delivery schedules and logistics to ensure timely availability of materials at the construction site; and
- provide technical support and assistance related to the installation or use of supplied products.

Government authorities provide regulatory oversight and approvals for construction projects, including permits, licences and inspections.

3.5 Site

In Saudi Arabia, the responsibility for the status of the construction site – including issues such as pollution, underground obstacles, geotechnical conditions and archaeological finds – is typically shared between the employer (client) and the contractor.

This division of responsibility is often governed by a combination of mandatory or regulatory laws and contractually agreed-upon terms. Government regulations mandate compliance with environmental protection, archaeological preservation and site safety standards, while construction contracts allocate responsibilities for site investigations, mitigation measures and any unexpected discoveries or obstacles encountered during construction.

3.6 Permits

In Saudi Arabia, construction projects typically require various permits, including building permits, environmental permits and approvals for specific activities such as excavation or demolition. The responsibility for obtaining necessary permits is typically shared between the employer (client) and the contractor. Government regulations mandate compliance with permit requirements, while construction contracts may allocate responsibilities for permit procurement and specify procedures for obtaining necessary permits.

3.7 Maintenance

In Saudi Arabia, the party responsible for the maintenance of the works is typically outlined in the construction contract, with responsibilities often falling on the contractor during a defects liability period. Maintenance works generally involve ensuring the continued functionality, safety and appearance of the completed construction project. Maintenance tasks may

include routine inspections, repairs, cleaning and upkeep of infrastructure, buildings and systems. Maintenance agreements may be included in specific contracts other than the construction contract, outlining ongoing maintenance responsibilities and arrangements between parties.

3.8 Other Functions

In Saudi Arabia, other functions in the construction process (such as operation, finance and transfer) are typically instructed by the employer to the contractor or third parties through contractual agreements. These functions may involve tasks such as:

- project-financing arrangements;
- operation and maintenance agreements for completed projects; and
- transfer of ownership or operational control upon completion.

Instructions for these functions are governed by contractual agreements between the parties involved in the construction project.

3.9 Tests

In Saudi Arabia, the typical process for testing the completion of works involves co-ordination between the contractor, employer and (possibly) third-party specialists. The specific tests conducted depend on the nature of the project and contractual requirements. Responsibilities for testing are typically divided as follows.

Contractor

The contractor is responsible for performing tests in accordance with the contract specifications, ensuring that the works meet the required standards and quality criteria.

Employer

The employer oversees the testing process, ensuring that it is carried out in accordance with the contract requirements. The employer may also engage third-party specialists to conduct independent tests or inspections to verify compliance.

Third-Party Specialists

In some cases, third-party specialists such as testing laboratories or engineering firms may be hired to conduct specific tests or inspections as part of the completion process. Their role is to provide impartial assessments of the works' compliance with technical standards and specifications.

3.10 Completion, Takeover and Delivery

In Saudi Arabia, the processes of completion, takeover and delivery in construction projects are closely related and influence each other.

Completion refers to the point at which the construction works are finished according to the contract requirements.

Takeover occurs when the employer formally accepts the completed works from the contractor, typically after inspections and testing to ensure compliance with specifications.

Delivery involves transferring possession and control of the completed works to the employer.

These processes influence each other as the completion of works triggers the initiation of takeover procedures, and successful takeover precedes the formal delivery of the project. A certificate of completion is often issued to prove the completion of the project.

3.11 Defects and Defects Liability Period

In general, the contractor can be held liable for defects in the works for a specified warranty period agreed upon in the contract, typically ranging from one to five years. Contractual periods for discovering defects are often agreed upon between parties, outlining the timeframe within which defects must be identified and reported.

Remedies available to the employer in the event of a defect include:

- requiring the contractor to remedy the defect;
- withholding payments; or
- seeking damages for losses incurred.

These remedies may vary after takeover by the employer, depending on the contract terms. While there are no specific mandatory or regulatory laws governing the period for notifying the contractor of defects in Saudi Arabia, failure to notify the contractor within the agreed-upon timeframe may limit the employer's ability to seek remedies or damages for the defect.

4. Price

4.1 Contract Price

In Saudi Arabia, methods of establishing the contract price typically include:

- lump sum;
- unit price;
- cost-plus; and
- target cost.

The contract price is generally made up of various components, such as:

- labour costs;
- material costs;

- overheads;
- profit margins; and
- any other agreed-upon expenses.

Milestone payments are commonly used in construction contracts in Saudi Arabia, where payments are made upon the achievement of predetermined project milestones or stages of completion.

4.2 Indexation

In Saudi Arabia, indexation of prices is commonly used in construction contracts to manage the risk of price fluctuations. The risk of large price fluctuations is typically divided between parties through contractual provisions specifying the method of indexation, such as tying prices to a specific cost index or allowing for adjustments based on changes in market conditions.

4.3 Payment

In Saudi Arabia, typical measures in construction contracts to manage late or non-payment include provisions for advanced payments, delayed payments and interim payments.

Advanced payments may be provided to the contractor to mobilise resources and start work, while delayed payments may incur penalties or interest charges for late payment. Interim payments are often based on completed work or milestones achieved, ensuring ongoing cash flow for the contractor throughout the project.

4.4 Invoicing

In Saudi Arabia, typical means of invoicing in construction contracts include:

- milestone-based invoicing;
- progress payments based on completed work; and
- interim payment certificates.

Invoices are often submitted by the contractor to the employer at specified intervals, reflecting the percentage of work completed or milestones achieved according to the contract terms.

5. Time

5.1 Planning and Programme

In Saudi Arabia, planning in construction contracts typically involves collaboration between the employer, contractor and other parties.

The employer defines project objectives and requirements, while the contractor develops a construction plan to meet these objectives. Other parties, such as consultants and subcontractors, may provide input and expertise during the planning process.

Planning is safeguarded through contractual provisions requiring the submission and approval of construction plans and schedules. Milestones, milestone payments and certificates are commonly used in Saudi Arabia to track progress and ensure that contractual obligations are met at key stages of the project.

5.2 Delays

In Saudi Arabia, in the event of delays, parties typically follow a process outlined in the contract, including:

- notifying each other of delays;
- assessing responsibilities; and
- seeking resolution through negotiation or dispute resolution mechanisms.

Typical obligations of the parties include:

- mitigating delays;
- providing timely notice of delays; and

Contributed by: Alex Saleh, Mohammad Nader Al Awadhi, Rana Moustafa and Shahad Al-Humaidani, GLA & Company

- co-operating to minimise impacts on the project.

Time-related costs are usually addressed through provisions in the contract, which may include mechanisms for compensating the affected party for additional costs incurred due to delays. Legal and/or contractual arrangements on concurrent delays may vary but often involve apportioning responsibility based on the cause and impact of delays, with the contract determining how concurrent delays are addressed and resolved.

5.3 Remedies in the Event of Delays

In Saudi Arabia, remedies generally available to the employer in the event of delays include:

- imposing liquidated damages;
- terminating the contract; or
- seeking specific performance remedies.

Liquidated damages are often specified in the contract and allow the employer to claim compensation for delays. Termination of the contract may be an option if the delays are substantial or persistent. Specific performance remedies may involve requiring the contractor to accelerate the work or take other measures to mitigate the delays.

5.4 Extension of Time

In Saudi Arabia, a contractor typically requests an extension of time by submitting a formal written notice to the employer, detailing the reasons for the delay and providing supporting documentation. Grounds for awarding an extension of time may include:

- unforeseen site conditions;
- design changes;
- force majeure events; or

- delays caused by the employer or other parties.

The extension of time is usually established, measured and proven through documentation – such as progress reports, correspondence, site records and expert analysis – demonstrating the impact of the delay on the project schedule.

5.5 Force Majeure

The application of force majeure in construction contracts is particularly relevant due to the inherent risks and uncertainties associated with construction projects. In Saudi Arabia, the application of force majeure in construction contracts is influenced both by general principles of contract law and by specific provisions of Saudi Arabian law. The Saudi Arabian legal system is based on Islamic law (Sharia), and contracts are generally governed by the principles of freedom of contract and good faith.

In the case of construction public procurement contracts, Article No 144 of the Government Tender and Procurement Law (GTPL) allows a party to a public procurement contract to seek to delay performance under the contract for a certain time proportional to the delay caused by force majeure. The contractor must also prove that the delay was due to “critical circumstances” or “causes beyond his control”.

To invoke force majeure in a construction contract in Saudi Arabia, the party seeking relief must demonstrate that the event in question meets the criteria specified in the force majeure clause. These criteria typically include:

- the occurrence of an event beyond the control of the parties;
- the event’s impact on the party’s ability to perform its contractual obligations; and

Contributed by: Alex Saleh, Mohammad Nader Al Awadhi, Rana Moustafa and Shahad Al-Humaidani, GLA & Company

- the absence of any reasonable measures that could have been taken to mitigate or avoid the event.

5.6 Unforeseen Circumstances

In Saudi Arabia, unforeseen circumstances in construction contracts are addressed through a combination of mandatory or regulatory law and contractual agreements between the parties.

Saudi Arabian law provides certain provisions governing unforeseen circumstances in construction contracts. Article 97 provides a potential route to relief upon the occurrence of “exceptional circumstances of a general character”, provided that the circumstances were not foreseeable at the time of entering into the contract. It is a “mandatory” term, meaning that any provision to the contrary is considered void.

In construction contracts in Saudi Arabia, addressing unforeseen circumstances typically involves the following approaches.

Force Majeure Clauses

Contracts may include force majeure clauses defining events or circumstances beyond the parties’ control, such as:

- natural disasters;
- acts of terrorism; or
- government actions.

These excuse performance or provide for extensions of time and/or adjustments to contract terms.

Change Order Procedures

Contracts often establish procedures for addressing changes in project scope, specifications or conditions due to unforeseen circumstances. This may involve:

- formal change order requests;
- negotiations between the parties; and
- adjustments to contract terms, including time extensions and additional compensation.

Notice Requirements

Contracts may include provisions requiring parties to provide timely notice of unforeseen circumstances (such as delays, disruptions or events triggering force majeure) to ensure prompt action and mitigation of potential impacts on the project.

Dispute Resolution Mechanisms

Construction contracts typically include provisions for resolving disputes arising from unforeseen circumstances (such as mediation, arbitration or litigation) to ensure timely and effective resolution of issues that cannot be resolved amicably between the parties.

5.7 Disruption

In Saudi Arabia, disruption is generally acknowledged as a valid ground for seeking an extension of time and/or compensation in construction contracts, provided that it meets certain criteria and is supported by contractual provisions or legal principles. Disruption refers to any event or circumstance that significantly impacts the progress or efficiency of the construction works, resulting in delays, increased costs or reduced productivity.

Establishing, measuring and proving disruption typically involves several steps, as follows.

Contractual Provisions

The construction contract may include provisions that specifically address disruption as a permissible ground for extension of time and/or compensation. These provisions may:

Contributed by: Alex Saleh, Mohammad Nader Al Awadhi, Rana Moustafa and Shahad Al-Humaidani, GLA & Company

- define disruption;
- specify the circumstances under which it applies; and
- outline the procedures for notifying the other party and documenting the impact of disruption events.

Documentation

Parties affected by disruption events should maintain detailed records documenting the occurrence, duration and impact of the disruption on the project schedule, productivity and costs. This documentation may include:

- daily progress reports;
- project schedules;
- correspondence;
- meeting minutes; and
- other relevant records.

Causation Analysis

Parties seeking an extension of time and/or compensation must demonstrate a causal link between the disruption event and the resulting delays or impacts on the project. This may involve:

- analysing the sequence of events;
- identifying the specific causes of disruption; and
- assessing their direct and indirect effects on the project's progress and performance.

Quantification of Losses

Once disruption is established, parties may need to quantify the resulting delays, costs or losses attributable to the disruption event. This may involve:

- assessing the additional time and resources required to complete the affected work;
- calculating the associated costs; and

- determining any resulting impacts on project milestones or critical path activities.

Expert Analysis

In complex cases or disputes involving disruption, parties may enlist the assistance of experts (such as delay analysts, quantity surveyors or construction claims consultants) to assess and quantify the impact of disruption objectively. These experts can provide independent analysis and expert testimony to support the parties' claims for extension of time and/or compensation.

6. Liability

6.1 Exclusion of Liability

Please see 9.2 Restricting Remedies.

6.2 Wilful Misconduct and Gross Negligence

It is stated in the Civil Code and enshrined in Sharia principles that compensation must be set out if wilful misconduct is detected.

6.3 Limitation of Liability

Please see 9.4 Excluded Damages.

7. Risk, Insurance and Securities

7.1 Indemnities

Indemnities are commonly used in Saudi Arabia, particularly in construction contracts, to limit risk and allocate responsibilities between parties. An indemnity is a contractual provision where one party agrees to compensate the other for specified losses, damages or liabilities arising from certain events or circumstances. Typical subjects for which one party would indemnify another in Saudi Arabia include the following.

Contributed by: Alex Saleh, Mohammad Nader Al Awadhi, Rana Moustafa and Shahad Al-Humaidani, GLA & Company

Third-Party Claims

One party may indemnify the other against claims, lawsuits or liabilities brought by third parties, including but not limited to claims for:

- bodily injury;
- property damage; or
- financial losses arising from the project.

Professional Negligence

Professionals such as architects, engineers or consultants may indemnify their clients or employers against claims arising from errors, omissions or negligence in their professional services.

Breach of Contract

Parties may indemnify each other for losses resulting from breaches of contractual obligations, including:

- failure to perform work as agreed;
- delays in project completion; or
- failure to meet quality standards.

Environmental Liabilities

Indemnities may cover environmental liabilities (such as contamination or pollution caused by the construction activities), ensuring that one party bears the costs of remediation or cleanup.

Regulatory Compliance

Parties may indemnify each other for losses resulting from non-compliance with laws, regulations or permits related to the project, including fines, penalties or legal expenses incurred as a result.

Product Liability

Manufacturers or suppliers may indemnify purchasers or users of their products against claims

for injuries or damages caused by defective products used in the construction project.

7.2 Guarantees

In Saudi Arabia, parties in construction contracts often use guarantees to limit risks. These guarantees provide assurance that contractual obligations will be fulfilled and serve as financial security in the case of default. Methods of providing guarantees include the following.

Bank Guarantees

Issued by banks, these guarantees assure payment or performance on behalf of the party. They may take the form of bid bonds, performance bonds or advance payment bonds.

Parent Company Guarantees

A parent company may provide a guarantee on behalf of its subsidiary, ensuring performance or payment obligations.

Retention Funds

Retention funds are withheld from payments and held in escrow until the satisfactory completion of the contract, serving as a form of guarantee for the paying party.

Insurance Guarantees

Insurance policies, such as performance or payment bonds, can serve as guarantees, covering losses in the case of default.

The use of guarantees in construction contracts is often governed by mandatory or regulatory law in Saudi Arabia, particularly regarding the form and enforceability of these guarantees. For example, the Saudi Arabian government may require specific types of guarantees for public contracts to ensure project completion and mitigate risks.

Contributed by: Alex Saleh, Mohammad Nader Al Awadhi, Rana Moustafa and Shahad Al-Humaidani, GLA & Company

The scope of guarantees varies depending on the parties involved and the nature of the contract. Generally, guarantees cover obligations such as:

- completion of work within specified time-frames;
- quality of workmanship and materials;
- payment of subcontractors and suppliers;
- compliance with contractual specifications and regulations; and
- compensation for damages or losses incurred due to default or non-performance.

7.3 Insurance

In construction contracts in Saudi Arabia, parties typically obtain various types of insurance to mitigate project risks. These include:

- contractor's all-risk (CAR) insurance covering damage to works and equipment;
- professional indemnity (PI) insurance protecting against professional negligence claims;
- public liability insurance for third-party injuries or property damage;
- employer's liability insurance for workplace injuries;
- third-party liability insurance for subcontractors; and
- delay in start-up (DSU) insurance covering losses from project delays.

These insurances collectively cover property damage, bodily injury, professional negligence and financial losses, ensuring project success while transferring and mitigating risks.

7.4 Insolvency

Saudi Arabia's Bankruptcy Law, Royal Decree No M50/1439 (Saudi Arabia Cabinet Decision No 264/1439), enacted in 2018, applies to individuals, corporations and non-Saudi investors with

assets or business operations in the Kingdom. Similar to Federal Decree-Law No 9/2016, it aims to modernise insolvency legal frameworks.

The law provides for protective/preventative settlement options and insolvency procedures allowing for restructuring or liquidation. These procedures include:

- preventative settlement;
- allowing debtors to request suspension of claims for up to 180 days;
- financial restructuring supervised by a court-appointed financial restructuring officer; and
- liquidation in cases of insolvency or bankruptcy.

7.5 Risk Sharing

Sharing responsibility for certain risks is common practice in construction contracts in Saudi Arabia. Risks such as design changes, unforeseen site conditions and force majeure events may be shared by the parties through contractual provisions. Construction contracts typically arrange for risk sharing by:

- allocating responsibilities;
- specifying procedures for addressing risks; and
- determining how costs associated with shared risks will be allocated between the parties.

Shared risks are generally priced in Saudi Arabia through negotiated agreements on cost sharing, contingency provisions or insurance arrangements.

For construction in the public sector, Article 68 of Saudi Arabia Cabinet Decision No 649/1440 on the Government Tenders and Procurement Law states that the prices of contracts and

framework agreements may be only amended by increasing and decreasing in the following cases:

- change of prices of the materials or main services included in the tender provisions and designated under the Regulation;
- amendment of the customs tariff, fees or taxes; and
- in the case of unpredictable financial difficulties arising during the period of execution of the contract.

Article 69 of Saudi Arabia Cabinet Decision No 649/1440 on the Government Tenders and Procurement Law also adds that the government entity may only issue change orders by increases of no more than 10% of the contract value, and by decreases of no more than 20% of the value.

8. Contract Administration and Claims

8.1 Personnel

In construction contracts in Saudi Arabia, provisions regarding personnel typically outline the roles, responsibilities, qualifications and management of individuals involved in the project. Key personnel (such as project managers, engineers and supervisors) are identified, with specific qualifications and experience required. The contract defines their duties, reporting lines and authority, while also addressing the process for substitution or replacement, if necessary.

Training and development opportunities may be mandated to ensure ongoing competence. Performance evaluation mechanisms are established, along with requirements for compliance with laws, regulations and confidentiality agree-

ments. These provisions aim to ensure that the project is staffed appropriately, with competent individuals who fulfil their duties effectively and comply with legal and contractual requirements, ultimately contributing to the project's successful completion.

8.2 Subcontracting

In construction contracts in Saudi Arabia, subcontracting is a common practice that involves delegating certain portions of the work to third-party subcontractors. The general contractual possibilities and limitations of subcontracting in these contracts can vary depending on the specific terms negotiated between the parties. The following are some key points to consider.

Possibilities of Subcontracting

Flexibility

Construction contracts often allow for subcontracting to provide flexibility in project management and resource allocation.

Specialised expertise

Subcontracting allows the contractor to leverage the specialised expertise of subcontractors for specific aspects of the project.

Resource optimisation

Subcontracting can help optimise resources by allocating tasks to subcontractors who may have greater capacity or efficiency in certain areas.

Risk management

Subcontracting certain portions of the work can help manage risks associated with schedule delays, labour shortages or technical challenges.

Limitations of Subcontracting

Approval requirements

Some contracts may require the client's approval before subcontracting any portion of the work.

Contributed by: Alex Saleh, Mohammad Nader Al Awadhi, Rana Moustafa and Shahad Al-Humaidani, GLA & Company

Quality control

The main contractor remains ultimately responsible for the quality of the work, even if subcontracted. Therefore, there may be limitations on subcontracting to ensure quality control and compliance with contract specifications.

Liability

The main contractor typically retains liability for the subcontractors' work, so there may be limitations on subcontracting to minimise legal risks and liabilities.

Payment terms

Payment terms for subcontractors may be subject to the main contract's payment terms, with limitations on the main contractor's ability to modify or delay payments to subcontractors.

Performance bonds and guarantees

Some contracts may require subcontractors to provide performance bonds or guarantees, to ensure their performance and mitigate risks associated with subcontracting.

8.3 Intellectual Property

In construction contracts in Saudi Arabia, intellectual property (IP) provisions typically address ownership, licensing and use of IP rights related to the project. While the specific provisions may vary depending on the nature of the project and the parties involved, the following are some general contractual provisions regarding IP as commonly found in construction contracts in Saudi Arabia.

Ownership of IP

The contract should specify the ownership of IP rights created or developed during the course of the project. Typically, the contractor retains ownership of any pre-existing IP rights brought to the project, while the client or employer retains

ownership of any new IP rights created specifically for the project.

Licence Grants

The contract may include provisions granting the client or employer a licence to use any IP rights developed or delivered as part of the project. This licence may be exclusive or non-exclusive and/or limited or unlimited in scope, and may include sublicensing rights.

Confidentiality and Non-disclosure

Construction contracts often include provisions requiring the parties to maintain the confidentiality of proprietary information and IP related to the project. This helps protect sensitive information from unauthorised disclosure or use.

Indemnification

The contract may include provisions requiring one party to indemnify the other against any claims or liabilities arising from the infringement of third-party IP rights. This helps to allocate risk and to protect both parties from potential legal disputes related to IP infringement.

Warranties and Representations

The contractor may be required to warrant that the work performed under the contract does not infringe upon any third-party IP rights. Similarly, the client or employer may warrant that they have the necessary rights to use any IP provided to the contractor for the project.

9. Remedies and Damages

9.1 Remedies

Damage refers to harm, loss or injury caused to a person, property or entity. In the context of construction law, damage can occur in various forms, including:

Contributed by: Alex Saleh, Mohammad Nader Al Awadhi, Rana Moustafa and Shahad Al-Humaidani, GLA & Company

- physical damage to structures;
- financial loss;
- reputational damage; and
- personal injury.

In the event of damage in a construction project, parties may seek legal remedies to address the harm suffered. This may involve:

- filing insurance claims;
- pursuing litigation or arbitration; or
- engaging in alternative dispute resolution methods.

The specific legal framework and contractual provisions governing the construction project will determine the available options for seeking compensation or resolving disputes related to the damage. The NCTL stipulates that “the building guard shall be responsible for compensating the damage caused by the demolition of the building in whole or in part; unless it is proven that the damage was not caused by negligence in maintenance, age in construction or a defect in it”.

Previously, Saudi Arabia did not impose a ten-year commitment in this regard. As a result, consultants and contractors worked in the Kingdom without worrying about liability (except for government projects), and the parties’ agreement was the only basis for resolving construction and design issues arising from deficiencies identified after completion. However, *this is no longer the case*. The SBC requires a ten-year liability, and states the following:

“The supervising designer who supervises the implementation of the construction along with the contractor shall be jointly responsible for compensating the owner for ten years – from the date of issuance of the occupancy certificate

– for the total or partial demolition of the buildings they constructed or the facilities they built and for every hidden defect that threatens the durability and safety of the building.”

In the public sector, Article 71(3) of Saudi Arabia Cabinet Decision No 649/1440 on the Government Tenders and Procurement Law notes that, in all cases, the contractor will be jointly responsible with the subcontractor or sub-supplier for the execution of the contract according to the terms thereof.

9.2 Restricting Remedies

In Saudi Arabia, it is common practice for parties to contractually limit the remedies available to each other in various types of contracts, including construction contracts. These limitations on remedies serve to allocate risks, define the scope of liability and provide certainty to the parties involved. However, the extent to which remedies can be contractually limited may vary depending on the specific circumstances of each contract as well as the applicable laws and regulations in Saudi Arabia.

The following are some common ways in which the remedies available to parties can be contractually limited in Saudi Arabia.

Sole Remedy Clauses

Parties may include clauses in the contract stipulating that certain remedies are the sole and exclusive remedies available to them in the event of a breach or dispute. These clauses often limit the parties’ ability to seek additional remedies beyond those expressly provided for in the contract.

Limitation of Liability Clauses

Contracts may include clauses that limit the amount or types of damages that one party can

recover from the other in the event of a breach. These clauses typically specify a maximum cap on liability or exclude certain types of damages altogether.

Time Limits for Claims

Contracts may impose time limits within which parties must assert their claims or initiate legal proceedings in the event of a breach. Failure to adhere to these time limits may result in the forfeiture of certain remedies or rights.

Exclusion of Consequential Damages

Parties may agree to exclude consequential or indirect damages, such as lost profits or business interruption, from the list of recoverable damages in the event of a breach.

Liquidated Damages Clauses

Contracts may include provisions specifying predetermined amounts of damages that one party must pay to the other in the event of a specific type of breach. These liquidated damages clauses can limit the parties' ability to seek additional damages beyond the agreed-upon amounts.

While parties in Saudi Arabia have the freedom to negotiate and include such limitations on remedies in their contracts, it is important to note that certain limitations are imposed by law. For example, contractual provisions that contravene Sharia principles or public policy may not be enforceable. Additionally, courts in Saudi Arabia may scrutinise the fairness and reasonableness of contractual limitations on remedies, particularly if they are deemed to be unconscionable or overly one-sided.

9.3 Sole Remedy Clauses

Contractual sole remedy clauses, which limit the parties' remedies to those expressly stated in

the contract, are commonly used in construction contracts worldwide, including in Saudi Arabia. These clauses serve to define the extent of liability and provide certainty to both parties regarding their rights and obligations in the event of a dispute.

In Saudi Arabia, enforcing contractual sole remedy clauses involves adhering to the principles of contract law and ensuring that the clause is clear, unambiguous and freely negotiated by both parties. The following are some key points on how these clauses can be enforced.

Clear and Unambiguous Language

The sole remedy clause should be drafted in clear and unambiguous terms, explicitly stating that the remedies provided in the contract are exclusive and that parties waive any additional rights they may have under applicable laws.

Mutual Agreement

Both parties must agree to the sole remedy clause and understand its implications at the time of contract formation. It is essential that no coercion or undue influence is exerted during the negotiation process.

Fairness and Reasonableness

Courts in Saudi Arabia, as in many jurisdictions, will scrutinise the fairness and reasonableness of sole remedy clauses. If a clause is found to be unconscionable or overly one-sided, it may not be enforceable.

Compliance With Sharia

Construction contracts in Saudi Arabia may need to comply with Sharia principles. Therefore, any sole remedy clause should not contradict Sharia or public policy.

Contributed by: Alex Saleh, Mohammad Nader Al Awadhi, Rana Moustafa and Shahad Al-Humaidani, GLA & Company

Documentation and Evidence

In the event of a dispute, parties seeking to enforce a sole remedy clause should be prepared to provide documentation proving that the clause was freely negotiated and clearly understood by both parties, and that it complies with applicable laws.

Judicial Interpretation

Ultimately, the enforceability of a sole remedy clause may be subject to judicial interpretation. Courts in Saudi Arabia will consider the specific circumstances of the case, including the language of the clause, the intentions of the parties and any relevant legal principles.

Overall, while contractual sole remedy clauses are commonly used in construction contracts in Saudi Arabia, their enforceability depends on various factors, including:

- clarity of language;
- mutual agreement;
- fairness;
- compliance with applicable laws; and
- judicial interpretation.

9.4 Excluded Damages

According to Article 173 of Saudi Arabia's Cabinet Decision No 820/1444, parties are permitted to limit liability, similar to practices in other civil law jurisdictions, except in cases involving fraud or gross error. Additionally, under the Saudi Civil Code, liability cannot be excluded for harmful acts (tort).

Parties engaging in construction contracts in the Middle East are likely familiar with a form of strict liability known as "decennial liability". While the UAE Civil Code (Federal Law No 5/1985) explicitly holds contractors and consultants accountable for decennial liability within a ten-year period

in the case of structural failures, Saudi Arabia's Civil Code does not address this directly. However, decennial liability remains a significant aspect in the country.

The Implementing Regulations of the Saudi Building Code Application Law, also referred to as the "Building Regulations", incorporate decennial liability in Article 29. This states:

"The Supervising designer overseeing the construction implementation and the contractor shall be jointly responsible for compensating the owner for ten years – from the issuance date of the occupancy certificate – for any total or partial demolition of the buildings they constructed or the facilities they built, as well as for any hidden defects jeopardising the building's durability and safety."

Therefore, contractors and consultants involved in construction projects in Saudi Arabia must recognise that structural failures in construction works are fully covered under the no-fault system of decennial liability.

In construction contracts in Saudi Arabia, various forms of damages may be excluded from liability, depending on the specific terms negotiated between the parties. Some common forms of damages that might be excluded from liability in these contracts include the following.

Consequential Damages

These are indirect or secondary damages that arise as a consequence of the breach of contract but are not directly caused by it. Examples include lost profits, business interruption or additional expenses incurred due to delays.

Contributed by: Alex Saleh, Mohammad Nader Al Awadhi, Rana Moustafa and Shahad Al-Humaidani, GLA & Company

Punitive Damages

Punitive damages are intended to punish the breaching party rather than compensate the non-breaching party for losses incurred. In many jurisdictions, including Saudi Arabia, punitive damages are not typically awarded in contractual disputes.

Incidental Damages

These are the costs incurred as a direct result of the breach of contract, such as expenses related to finding an alternative contractor or repairing defective work. While incidental damages are often recoverable, they may be limited or excluded depending on the terms of the contract.

Liquidated Damages

Liquidated damages are predetermined amounts specified in the contract that one party agrees to pay the other in the event of a specific type of breach, such as delays in completing the project. However, if these damages are deemed excessive or punitive, they may be unenforceable under Saudi Arabian law.

General Damages

General damages are those that naturally flow from the breach of contract and are foreseeable at the time the contract is formed. These may include the cost of rectifying defective work or completing unfinished work, as well as any resulting property damage.

9.5 Retention and Suspension Rights

In Saudi Arabia, retention and suspension rights can vary depending on the terms negotiated in individual contracts. While it is not common practice to completely exclude these rights from contracts, parties may include specific provisions that limit or regulate their application.

Retention rights, which involve withholding payment until certain conditions are met, are typically included in construction contracts to ensure that work is completed satisfactorily. Similarly, suspension rights allow parties to temporarily halt work under certain circumstances, such as non-payment or breach of contract by the other party.

However, the extent to which these rights are exercised and regulated can differ from one contract to another. It is important for parties to clearly outline these rights and their conditions in the contract, to avoid misunderstandings and disputes during the execution of the project. Additionally, any limitations or exclusions of these rights should be clearly stated in the contract to ensure compliance with applicable laws and regulations in Saudi Arabia.

9.6 Termination

If the contract is terminated due to the contractor(s) breaching the contract and the law for valid reasons, the contractor(s) will bear responsibility upon termination. They may not be entitled to any compensation for their failure to fulfil their obligations.

In the public sector, government contractors will not be entitled to damages if the contract is terminated.

In the absence of specific laws, rules or regulations governing construction contracts in the private sector, as well as contracts in general, parties will rely on the terms outlined in the agreement signed between them. If the agreement does not address dispute resolution, they will typically follow customary practices applicable to commercial transactions.

Contributed by: Alex Saleh, Mohammad Nader Al Awadhi, Rana Moustafa and Shahad Al-Humaidani, GLA & Company

The Civil Code of Saudi Arabia, under Cabinet Decision No 820/1444, encompasses various provisions regarding the termination of contracts. These include:

- termination by mutual consent (Article 105);
- termination through the exercise of an option (Article 106);
- termination for breach of obligations (Article 107); and
- termination due to impossibility of performance (Article 110).

Specifically tailored to construction contracts, Cabinet Decision No 820/1444 outlines termination possibilities for muqawala contracts in Articles 475–478. These scenarios include:

- termination upon completion of the works;
- termination by either party in the case of an emergency excuse related to contract performance (with compensation for resultant damages);
- termination if the contractor is unable to complete the work due to reasons beyond their control (with entitlement to payment for completed work and incurred expenses); and
- termination upon the death of the contractor if personal qualifications were a material consideration in the contract.

Therefore, parties involved in construction contracts should take into account these specialised provisions within the muqawala section of the Civil Code when navigating the termination of their agreements.

10. Dispute Resolution

10.1 Regular Dispute Resolution

Construction disputes in Saudi Arabia are typically resolved through local courts or arbitration. The jurisdiction depends on the parties' agreement or the provisions of the contract.

10.2 Alternative Dispute Resolution

Mediation and arbitration are commonly used methods for resolving construction disputes in Saudi Arabia. Parties often include arbitration clauses in their contracts, specifying the arbitration rules and procedures to be followed.

The Saudi Arabian Arbitration Law, enacted in 2012, provides a comprehensive legal framework for arbitration proceedings in the country. It incorporates internationally recognised principles of arbitration, such as the recognition and enforcement of arbitral awards.

Article 92 of Saudi Arabia Cabinet Decision No 649/1440 regarding the Government Tenders and Procurement Law allows government entities to settle disputes through arbitration, subject to approval from the Finance Minister. Meanwhile, Article 154 of the same decision stipulates that Saudi Arabian laws will govern such disputes, and arbitration procedures will not be recognised outside the Kingdom except in contracts involving foreign contractors.

In the private sector, parties have the liberty to opt for arbitration to resolve disputes, ensuring that the arbitration process complies with Sharia principles.

SLOVENIA



Law and Practice

Contributed by:

Andrej Andrić

Andrić & Partners

Contents

1. General p.551

1.1 Governing Law p.551

1.2 Standard Contracts p.551

2. Parties p.551

2.1 The Employer p.551

2.2 The Contractor p.551

2.3 The Subcontractors p.551

2.4 The Financiers p.552

2.5 The Designer p.552

3. Works p.552

3.1 Scope p.552

3.2 Variations p.552

3.3 Design p.553

3.4 Construction p.553

3.5 Site p.553

3.6 Permits p.554

3.7 Maintenance p.554

3.8 Other Functions p.554

3.9 Tests p.554

3.10 Completion, Takeover and Delivery p.555

3.11 Defects and Defects Liability Period p.555

4. Price p.555

4.1 Contract Price p.555

4.2 Indexation p.555

4.3 Payment p.555

4.4 Invoicing p.556

5. Time p.556

5.1 Planning and Programme p.556

5.2 Delays p.556

5.3 Remedies in the Event of Delays p.556

5.4 Extension of Time p.556

5.5 Force Majeure p.556

5.6 Unforeseen Circumstances p.556

5.7 Disruption p.556

6. Liability p.557

- 6.1 Exclusion of Liability p.557
- 6.2 Wilful Misconduct and Gross Negligence p.557
- 6.3 Limitation of Liability p.557

7. Risk, Insurance and Securities p.557

- 7.1 Indemnities p.557
- 7.2 Guarantees p.557
- 7.3 Insurance p.557
- 7.4 Insolvency p.557
- 7.5 Risk Sharing p.557

8. Contract Administration and Claims p.558

- 8.1 Personnel p.558
- 8.2 Subcontracting p.558
- 8.3 Intellectual Property p.558

9. Remedies and Damages p.558

- 9.1 Remedies p.558
- 9.2 Restricting Remedies p.558
- 9.3 Sole Remedy Clauses p.558
- 9.4 Excluded Damages p.558
- 9.5 Retention and Suspension Rights p.558
- 9.6 Termination p.558

10. Dispute Resolution p.559

- 10.1 Regular Dispute Resolution p.559
- 10.2 Alternative Dispute Resolution p.559

Contributed by: Andrej Andrić, **Andrić & Partners**

Andrić & Partners comprises a team of six adept legal professionals specialising in corporate law, real estate law, construction law, and IT law. Guided by principles of prompt responsiveness and adaptability, Andrić & Partners is dedicated to the constant enhancement of the quality of its services. Strategically situated in central Ljubljana, its offices afford convenient access to pivotal judicial, administrative and other establishments, facilitating swift and ef-

fective advocacy on behalf of clients. Within the construction sector, the firm's expertise spans retail networks, development financing, cross-border transactions and expropriation procedures. The company currently provides counsel to large international companies embarking on expansion initiatives in Slovenia and abroad, and offering comprehensive legal guidance for the establishment of new locations.

Author



Andrej Andrić is the managing partner of Andrić & Partners and his primary practice areas are real estate law, corporate law, construction law and insolvency law. Andrej is a highly regarded and sought-after expert in the

fields of real estate law and construction law, in particular. Due to his exceptional language skills and additional certification as a German-speaking court interpreter, he is trusted by numerous foreign and domestic clients conducting business in Slovenia.

Andrić & Partners

Štefanova ulica 13A
1000 Ljubljana
Slovenia

Tel: +386 1 43 00 333
Fax: +386 1 43 00 320
Email: info@andric.si
Web: www.andric.si



1. General

1.1 Governing Law

The principal laws governing construction matters in the Republic of Slovenia are the Construction Act (GZ-1), the Code on Obligations (OZ) and the Spatial Management Act (ZUreP-3). In addition to these, construction contracts may be governed by the Special Construction Usages specifying the rights and obligations of the contracting parties in more detail, although these may be excluded from the contractual relationship should the parties choose.

1.2 Standard Contracts

The Republic of Slovenia has no provisions mandating the use of a standardised construction or construction-related contract. International Federation of Consulting Engineers (FIDIC)-approved provisions are the most widely used when it comes to the involvement of international investors and are even stipulated as necessary in some projects financed by state or EU cohesion funds. Those most commonly used are the FIDIC red, yellow and silver books. In accordance with historical practice, they are mostly applied in order to regulate the employer-contractor relationship.

tion supervision, and must notify the contractor of the identity of the nominated supervisor. Employers typically have no direct relationship with subcontractors although they may, under certain conditions, be directly liable to subcontractors, should the contractor not fulfil its obligations towards the subcontractors. Employers generally finance their own construction projects. However, should a project be financed by a third-party financier, the latter usually has no relationship with any party to the construction other than the employer (eg, by means of a loan agreement).

2.2 The Contractor

Contractors are legal entities, mainly limited liability companies or independent entrepreneurs. They are required to maintain a construction log and a construction ledger and carry out all the work necessary for completion of the construction project in accordance with the construction contract, applicable standards, laws and technical regulations, as well as to perform other administrative/organisational tasks related to the safety and maintenance of the construction site. Furthermore, they are responsible for the work of the subcontractors whom they have entrusted with the execution of the work.

2. Parties

2.1 The Employer

Employers in Slovenia are mostly legal entities, generally in the form of limited liability companies. They must procure the permits necessary for a construction project, hand over the construction site and all the documentation necessary for the execution of the construction project to the contractor, and pay the agreed amounts in accordance with the construction contract. They have the right to appoint and carry out construc-

2.3 The Subcontractors

Unless otherwise specified in the construction contract, the contractor does not have to carry out the work personally but may contract it out to subcontractors. Subcontractors, as well as contractors, are legal entities, usually limited liability companies and independent entrepreneurs. Subcontractors follow the instructions and demands of the contractor, who remains solely liable for the performance of the work in relation to the employer, as if performed by the contractor. Following the fulfilment of certain legal conditions, subcontractors may turn

directly to the employer for the payment of fees that have not been settled by the contractors.

2.4 The Financiers

Financiers are most often banks or investment funds. In principle, the financier has no relationship with any party involved in the construction other than the employer, unless explicitly agreed otherwise with individual participants in the construction project.

2.5 The Designer

Legal entities, such as limited liability companies or independent entrepreneurs, typically act as designers. In general, the designer is responsible for preparing a project's documents. The designer follows the wishes and instructions of the employer (investor) but, most importantly, is responsible for ensuring that a project's documents are prepared in compliance with the law. The contractor is obliged to follow the documentation produced by the designer. The contractor's performance is overseen by a supervisor, who may be a third party separate from the designer; or, if a special agreement is in place, the designer may also supervise the contractor's work.

3. Works

3.1 Scope

The scope of the project is covered by the technical documentation, which is prepared by the designer, usually at the employer's request, accompanied by a detailed specification of the work to be carried out. The designer is a legal entity or a natural person who, as a participant in construction projects, prepares the technical documentation and meets the conditions under the law governing architecture and engineering. The technical documentation is a systematically

arranged set of plans or technical descriptions, reports, calculations, drawings and other annexes which determine the location as well as the functional, design and technical characteristics of the construction work. A building permit is issued based on the technical documentation, in accordance with which the contractor is required to carry out the construction. From the point of view of contractual law, it is advisable to stipulate contractually any employer requirements that go beyond the works defined in the building permit.

3.2 Variations

There are typically two options for determining the scope and price of variations if these are requested by the employer, as follows.

- The parties determine ahead of the project and in the underlying construction contract the price of any potential variations requested by the employer, or at least a mechanism for determining this price.
- The parties are completely free to negotiate the price of variations. In this case, the employer must request that the contractor send a quotation for additional works, including the price, the period of performance and the period of validity of the quotation. Once there is agreement between the parties, they conclude an addendum to the construction contract.

However pursuant to Slovenian legislation, if it has been agreed that the price for the work will not be changed if, after the conclusion of the construction contract, the prices of the elements on the basis of which it was fixed have increased, the contractor may, notwithstanding such a contractual provision, request a change if the prices of the elements have increased to such an extent that the price for the work should

have been increased by more than 10%. However, in this case, the contractor may only claim a price difference exceeding 10%, unless the prices of the items have increased after the contractor has been in default.

In the opposite case, if, between the conclusion of the construction contract and the performance of the contractor's obligations, the price of the elements on the basis of which the price of the work was set has fallen by more than 2% and the work has been carried out within the agreed time limit, the contractor will have the right to require a corresponding reduction in the agreed price for the work in excess of that percentage. Where it has been agreed that the price for the work will not be changed and the work has been completed within the agreed time limit, the employer will be entitled to a reduction in the agreed price in the event that the prices for the elements on the basis of which it was fixed have decreased so much that the price would have been more than 10% lower, and by a difference of more than 10%. If the contractor is in default, the employer will be entitled to a proportionate reduction in the price for the work for each reduction in the price for the elements on the basis of which that price was fixed.

Time-related costs are usually not charged as they are included in the construction service.

3.3 Design

The technical documentation is prepared by the designer, usually on the basis of a design contract concluded with the employer. The designer's task is to ensure, in accordance with the rules of their profession, that the documentation is prepared in such a way that it complies with statutory and professional requirements. The designer is responsible to the employer for the

content and correctness of the technical documentation used to obtain a building permit.

3.4 Construction

After the building permit is obtained, the employer concludes a construction contract with the contractor who is responsible for carrying out the work in accordance with the building permit and technical documentation. In order to ensure that the work is carried out correctly, the employer must nominate a supervisor who is responsible, in relation to the employer, for overseeing the contractor's work and is usually entitled to act and issue binding instructions on behalf of the employer.

3.5 Site

The contractor is responsible for the layout, protection and appropriate marking of the construction site and must ensure the safety of the locality, those working on it, passers-by, traffic, neighbouring properties and the surrounding area.

During construction, the contractor must give access to the construction area to the designer who drew up the design documentation for the construction and to the designer of the design documentation for the execution of the works. The contractor is also required to give access to the investor, the supervisor and the occupational safety and health coordinator. Once construction is completed, the contractor is obligated to remove construction obstructions and any access restrictions and to clean and dispose of waste from the site area in an appropriate manner. Any special requirements regarding pollution, obstacles, geotechnical conditions and, in particular, archaeological finds are usually dealt with by the employer at the building-permit obtention phase, as the employer is also typically obliged to obtain consents and permits.

Mandatory or regulatory laws govern the regulations around building permits or any other required consents, and the supervisor is responsible for ensuring that the requirements of the Construction Act are met in respect of these, with any errors avoided and any preventive action taken on a timely basis. The supervisor must verify that a final consent or final building permit, if required, has been obtained before taking over the work. The supervision manager, appointed by the supervisor, manages and coordinates the overall supervision of the construction project.

3.6 Permits

Construction usually requires notification of the start of the construction process and a final building permit which is issued on the basis of the technical documentation provided and submitted by the designer on behalf of the employer. In the case of minor structures, the construction may be carried out without a permit. Once construction work is complete, the employer is generally obliged to obtain a fit-for-use permit, unless the construction was carried out without a building permit, or the structure is merely temporary. The employer remains solely responsible for acquiring the building permit and all other permits in accordance with the Construction Act. The new Construction Act (GZ-1) also establishes the possibility of obtaining a final building permit in a summary determination procedure. Therefore, the competent administrative unit may issue a final building permit within 30 days based on complete documentation provided by the investor. The processes of obtaining the required permits mentioned above are governed by mandatory law.

3.7 Maintenance

Slovenian legislation does not include any special provisions as to which party is responsible

for the maintenance of the work during construction. The contractor is responsible for the maintenance of the entire construction site during the work itself, unless otherwise specified in the construction contract.

3.8 Other Functions

A supervisor appointed by the employer is also involved in the construction project. The supervisor's task is to oversee the work of the contractor and the designer so as to ensure compliance with the requirements of the construction contract and the Construction Act, preventative action and the timely handling of defects.

The employer is generally the party entitled to give instructions to all participants in the construction project, except for insurance companies and banks, as these are usually contracting parties of the contractor only to the extent that the contractor has to provide bank guarantees, bills of exchange, proof of insurance coverage, etc, to the employer.

3.9 Tests

According to the Construction Act, the employer must obtain a fit-for-use permit upon completion of the construction. This permit is issued, under the condition that the work in question has been carried out in accordance with the building permit, by the competent administrative authority for construction matters following a technical inspection conducted by a specifically appointed committee. The employer must apply for a fit-for-use permit no later than in the 30 days following notification by the contractor or supervisor that the construction is complete. If the employer fails to submit an application for a fit-for-use permit within the prescribed time limit, it may be submitted by the contractor, the supervisor or another person who is the owner

or holder of the rights in rem in the immovable property where the construction is located.

3.10 Completion, Takeover and Delivery

On completion of the work, the contractor is obliged to enter the date of completion in the construction log and invite the employer to accept and take the work over. The work is typically deemed to be completed upon the obtaining of the fit-for-use permit, although the parties may agree otherwise. The takeover process typically includes the contracting parties signing a handover protocol, detailing the work taken over and any potential defects to be remedied by the contractor.

3.11 Defects and Defects Liability Period

According to the general provisions of the Code of Obligations, the employer is obliged to inspect the work as soon as is reasonably practicable in the ordinary course of events and to inform the contractor immediately of any defects found. After inspection and acceptance of the work, the contractor is no longer liable for apparent defects which could and should have been identified during normal inspection, unless the contractor was aware of them but failed to point them out to the employer. This does not apply to hidden defects not noticeable at first sight, as the contractor remains liable for these for two years after the acceptance of the work. Furthermore, the contractor is liable for any defects in the solidity of the construction, should these appear during the ten years following the acceptance of the works.

The general provisions concerning liability may be expanded upon by the parties, and it is customary for the contractor to provide extra warranties and security instruments in the construction contract.

4. Price

4.1 Contract Price

Contract price is generally determined based on one of two options, as follows:

- the turnkey clause – this is widely used and means that the contractor is obliged to perform all the works necessary for the completion of the project, excluding additionally requested and unforeseeable works;
- unit of measurement – this means that the price is determined per unit of measurement, so the final price depends on the materials used and hours of work.

4.2 Indexation

Typically, indexation of the prices in construction contracts tends not to be used, although recent inflation has resulted in more frequent inclusion of index clauses. Since the employer commonly transfers all possible construction-related risks to the contractor, in a case where indexation of prices is included in a particular contract, this must be signed off and the risk will most likely mainly fall to the contractor. As mentioned in 3.2 Variations, possibilities regulated by law exist with regard to price adjustment.

4.3 Payment

Construction work is typically paid for monthly by the employer in accordance with the progress made by the contractor, based on the timeliness and correctness of the work carried out (reserved payments, contractual penalties, etc). Should the employer fail to fulfil its payment obligations, the contractor is usually entitled to suspend further work until payment or, ultimately, withdraw from the contract. For a major project, the employer provides payment guarantees.

4.4 Invoicing

The contractor typically invoices the work monthly in accordance with progress made and, upon its completion, a final settlement is made by both contracting parties with a breakdown of the settled and outstanding amounts.

5. Time

5.1 Planning and Programme

The timetable is usually agreed upon by the employer and the contractor and enforced by the supervisor engaged by the employer to act on its behalf. Should the contractor not comply with the timetable, a contractual penalty for the delay is usually imposed on the contractor, and, in certain cases, the employer may also withdraw from the contract and cash in a bank guarantee issued by the contractor's bank as an instrument securing timely and correct performance of the work.

5.2 Delays

In the event of any delays, the contractor usually informs the employer and asks for an extension. Should the employer deem the request to be well founded, it may grant the extension – typically, an annex to the underlying contract is concluded. Should the request not be well founded, the employer may make use of the remedies described under **5.1 Planning**. Time-related costs are not charged, as they are included in the construction service.

5.3 Remedies in the Event of Delays

See **5.1 Planning**.

5.4 Extension of Time

Please refer to **5.2 Delays**. Regarding the extension of time, initially the contractor informs the employer, then the employer evaluates the

request. Should the employer decide that the request for extension is well founded, the permission granted for extension should be included in a new annex to the contract.

5.5 Force Majeure

Force majeure means any unforeseen and unexpected event occurring independently of the will of the parties, and which the parties could not have foreseen at the time of conclusion of the contract, which affects the performance of the contractual obligations. The contracting parties may specify in the contract precisely which events will be considered force majeure. Extensions of time will be granted on the basis of an annex to the basic contract.

5.6 Unforeseen Circumstances

Unforeseen circumstances are set out in the Special Construction Usages that apply to construction relationships, unless explicitly excluded by the parties in the construction contract.

Should the contract price be determined by the turnkey clause (see **4.1 Contract Price**), the unforeseen circumstances are significantly limited.

The contracting parties may, as indicated in **5.5 Force Majeure**, additionally define what constitutes unforeseen circumstances.

5.7 Disruption

In the event of any disruptions, the contractor usually informs the employer and asks for an extension. Should the employer deem the request to be well founded, it may grant the extension. An annex to the underlying contract is concluded.

6. Liability

6.1 Exclusion of Liability

See 6.1 Exclusion of Liability.

6.2 Wilful Misconduct and Gross Negligence

See 6.1 Exclusion of Liability.

6.3 Limitation of Liability

The parties to the contract have the option to exclude liability for slight negligence, but the court may invalidate the related clauses if they result from an unequal relationship between the parties to the contract. The parties may agree on a maximum amount of damages if the amount so fixed is not manifestly disproportionate to the damage in question or if the law does not dictate otherwise in the particular case. The contractor may be free from liability in relation to the employer if it warned the employer that the requested work would not be appropriate but the employer insisted on its performance despite the contractor's warning.

under the construction contract. Additionally, the parties may agree that the employer reserve a share of the amounts owed to the contractor each month as a security instrument similar to the bank guarantees. Lately, insurance policies for the performance of work and for the rectification of defects within the warranty period have started to feature more prominently in construction projects instead of bank guarantees.

7.3 Insurance

The Slovenian Construction Act provides for compulsory construction insurance to cover damage arising in connection with carrying out the activity. The contractor would typically take out insurance covering the construction work, damage to the construction site and building, damage to the health or assets of third parties, force majeure, etc.

7.4 Insolvency

If insolvency proceedings are opened against the contractor or the employer, the construction contract usually provides for the possibility of withdrawal from the contract by the other party.

7. Risk, Insurance and Securities

7.1 Indemnities

The parties to the contract agree on the compensation at their own discretion. In most cases, the contractor is liable to the employer for delay and defective work. The contractor typically has insurance cover for different types of damage caused by the contractor in connection with the performance of the construction work.

7.5 Risk Sharing

Risk sharing is possible, but not common, as the employer typically transfers all possible construction-related risks to the contractor. Since risk sharing is not typical, there is no generally established standard for pricing shared risks. Indexes such as those for calculating the difference in the price of construction services may potentially be used.

7.2 Guarantees

Bank guarantees for the performance of work and for the rectification of defects within the warranty period are the most widely used instruments to ensure that the contractor fulfils its obligations

8. Contract Administration and Claims

8.1 Personnel

Construction contracts usually contain a provision stipulating that the contractor remains solely responsible for carrying out the work in relation to the employer, regardless of whether such personnel or subcontractors actually performed the work on the contractor's behalf.

8.2 Subcontracting

The contractor typically has the option to subcontract the work, unless otherwise specified in the construction contract. It is common, however, for the contractor to disclose its subcontractors to the employer prior to the conclusion of the construction contract.

8.3 Intellectual Property

All intellectual property is typically transferred to the employer to the extent necessary for the execution of the construction project.

9. Remedies and Damages

9.1 Remedies

In the event of a breach of the construction contract, the employer can claim restitution and damages against the offender or make use of security instruments issued in its favour. Ultimately, the employer may also withdraw from the contract.

In respect of the concurrent performance objection, the contractor also has the right to withhold the delivery of the Technical Examination Documentation if the employer's payments to date have not been made.

9.2 Restricting Remedies

The construction contract may limit the liability of the parties although, under Slovenian law, the right to seek a remedy before a competent court cannot be waived. However, arbitration clauses as a form of dispute resolution have been widely used recently. Arbitration clauses may be included in the construction contract or agreed by a separate contract for resolution of issues arising from a specific construction contract. Should an arbitration clause be agreed, it has an advantage before seeking a remedy before a competent court.

9.3 Sole Remedy Clauses

See 9.2 Restricting Remedies.

9.4 Excluded Damages

To the extent permitted, direct and consequential damages are typically limited, although liability for intent and gross negligence cannot be ruled out.

9.5 Retention and Suspension Rights

Retention and suspension rights stipulated under the general rules of obligations are typically not ruled out, unless explicitly agreed otherwise by the parties. Moreover, as stated in 9.2 Restricting Remedies, there is a trend currently in place of including arbitration clauses as a means of solving possible contractual issues.

9.6 Termination

The contracting authority may terminate the construction contract in certain cases. In the event of termination, the client must pay the contractor the appropriate part of the agreed price for the work done up to that time and fair compensation for the necessary costs. However, an opportunity must be given in any case to remedy the delay.

10. Dispute Resolution

10.1 Regular Dispute Resolution

Construction-related disputes are typically adjudicated by the specialised commercial law departments of the district courts. The location depends on the jurisdiction clause agreed upon by the parties.

10.2 Alternative Dispute Resolution

The parties may initiate a mediation procedure, but only where both parties agree to it. Mediation is very commonly used, both before and after the initiation of court proceedings. The parties may also agree that their dispute be settled in arbitration proceedings, although they must agree on an appropriate arbitration clause at the conclusion of the construction contract or at a later time.

Trends and Developments

Contributed by:

Andrej Andrić

Andrić & Partners

Andrić & Partners comprises a team of six adept legal professionals specialising in corporate law, real estate law, construction law, and IT law. Guided by principles of prompt responsiveness and adaptability, Andrić & Partners is dedicated to the constant enhancement of the quality of its services. Strategically situated in central Ljubljana, its offices afford convenient access to pivotal judicial, administrative and other establishments, facilitating swift and ef-

fective advocacy on behalf of clients. Within the construction sector, the firm's expertise spans retail networks, development financing, cross-border transactions and expropriation procedures. The company currently provides counsel to large international companies embarking on expansion initiatives in Slovenia and abroad, and offering comprehensive legal guidance for the establishment of new locations.

Author



Andrej Andrić is the managing partner of Andrić & Partners and his primary practice areas are real estate law, corporate law, construction law and insolvency law. Andrej is a highly regarded and sought-after expert in the

fields of real estate law and construction law, in particular. Due to his exceptional language skills and additional certification as a German-speaking court interpreter, he is trusted by numerous foreign and domestic clients conducting business in Slovenia.

Andrić & Partners

Štefanova ulica 13A
1000 Ljubljana
Slovenia

Tel: +386 1 43 00 333
Fax: +386 1 43 00 320
Email: info@andric.si
Web: www.andric.si



In recent years, Slovenia and other European countries have experienced labour shortages. These have affected almost all sectors of the Slovenian economy, and particularly the construction sector, for the following reasons.

Demographic Change

In Slovenia, as in most other European countries, demographic change is reflected in an ageing population, which generally means that older generations account for a larger share of the population than younger generations. Consequently, as economic growth continues, there are fewer people to fill the gap in the labour market. Demographic change is also reflected in the fact that many people are choosing to move from Slovenia to other EU countries, either in search of better economic opportunities or for other personal reasons. However, migration of Slovenian citizens to other European countries may not be the construction sector's biggest problem, as it has traditionally been dominated by manual workers from the former Yugoslav republics.

As all European countries are facing labour shortages, each is trying to adapt its work permit policy to attract more foreigners, including the potential workers from the former Yugoslav republics. This could mean fewer such available workers opting to apply for employment in Slovenia, or even current foreign workers deciding that they might move from Slovenia to other European countries.

Legislation on the Employment of Foreigners

The main regulation governing workers' rights in Slovenian law is the Labour Relations Act (ZDR-1). The Employment, Self-employment and Work of Foreigners Act (ZZSDT) and the Aliens Act (ZTuj-2) are also relevant to the employment of foreigners. The Labour Relations Act is a general regulation governing the rights of workers

and the procedure for exercising rights, while the Employment, Self-employment and Work of Foreigners Act is a specific regulation governing the conditions for employment, self-employment and work of foreigners and the related tasks of the Republic of Slovenia for the regulation and protection of the labour market. The Aliens Act determines the conditions and manner of entry, exit and stay of aliens in the Republic of Slovenia. In addition to the above regulations and directly applicable European legislation, Slovenia has concluded a number of bilateral agreements, mainly with the countries of the former Yugoslav republics, in order to facilitate the conditions for entry, residence and work of foreigners and thus attract a greater number of foreign workers.

While it is true that the number of foreign workers has increased over the years, this does not mean that the shortage of construction workers is diminishing. This is primarily because foreign workers are choosing to work in other available sectors. One of the main reasons workers do not want to move to Slovenia to work in construction is the country's somewhat outdated legislation around the current need for foreign workers and, related to that, issues around obtaining work permits and meeting conditions to achieve family reunification, etc. The difficulties surrounding work permits, as well as the better working conditions available to foreign workers elsewhere in Europe are all relevant reasons why an increasing number of workers might decide to move to other European countries.

Workers' Economic Considerations

As stated, all European countries are working to simplify the process of providing residence and work permits for foreign workers, but Slovenian legislation lags other jurisdictions in simplifying these procedures, with the result that foreign workers have moved to countries such as

Germany, Switzerland and Austria, reducing the pool of available labour from the former Yugoslav republics. Some neighbouring countries are trying to remedy the shortage of workers by looking outside Europe, and mainly to Asia – a trend which is particularly noticeable in the tourism sector.

Workers likely favour applying for employment in other EU countries over Slovenia for two main reasons.

First, in addition to the very extensive documentation that foreign workers have to obtain and submit to the competent authorities in Slovenia, they are also faced with long waiting times. Potential workers can wait for more than six months for a work permit and are not allowed to work in the intervening period, which causes additional problems, such as subsistence, with their livelihoods potentially threatened. Obtaining a work permit might be quicker in other European countries.

Second, working conditions and remuneration fall short of expectations. Many workers are promised certain conditions before they are hired but, even after the long waiting times endured to obtain a work permit, once they move to Slovenia they find that the working conditions are completely different from those promised. Further, taxation of labour costs in Slovenia is relatively high, leading to lower net wages. A growing number of people are moving to other European countries because they comparatively much better paid there.

Impact of Labour Shortages on the Economy

If working conditions do not improve and the construction sector cannot be made more appealing to both foreign and domestic workers, Slovenia's economy will suffer.

A shortage of construction workers could cause construction projects to be delayed, or prevent investors from even starting them, which means that it will not be possible to build much-needed new housing, particularly in the country's larger urban areas, such as the capital Ljubljana and second city Maribor. This will drive rents even higher and leave more people with no choice but to move from the larger cities to the surrounding towns or even relocate abroad, where the working and living conditions are better and more affordable. The increasing shortage of construction workers is pushing up labour prices, which is already affecting the market and also having an impact on renovations and real estate prices.

The shortage of construction workers will also affect the construction of kindergartens, schools, retirement homes and all related infrastructure.

The Solution to the Crisis

To tackle the problem, the factors that are causing it need to be isolated clearly and a long-term plan put in place, firstly identifying the target groups of individuals who wish to work in Slovenia's construction sector. At the outset, some kind of stimulation package could be introduced to further encourage young nationals who might be interested in working in construction, by offering them a scholarship during their studies, for example. Above all, policy on the recruitment of foreign workers needs to be improved, as construction is currently the one sector with the largest number of workers from abroad. Once the target groups have been recruited, a better system of supervision should be introduced, in particular to monitor employers and the way in which they implement employment contracts and respect workers' rights. Lastly, improvements should be properly communicated to potential workers so that they are aware of these and persuaded to choose to work in the construction sector.

SOUTH KOREA

Law and Practice

Contributed by:

Woojae Kim, Sangchul Kim, Yoon Park and Hannah Lee
Bae, Kim & Lee LLC



Contents

1. General p.567

- 1.1 Governing Law p.567
- 1.2 Standard Contracts p.567

2. Parties p.568

- 2.1 The Employer p.568
- 2.2 The Contractor p.568
- 2.3 The Subcontractors p.569
- 2.4 The Financiers p.569
- 2.5 The Designer p.570

3. Works p.571

- 3.1 Scope p.571
- 3.2 Variations p.571
- 3.3 Design p.571
- 3.4 Construction p.571
- 3.5 Site p.572
- 3.6 Permits p.572
- 3.7 Maintenance p.572
- 3.8 Other Functions p.573
- 3.9 Tests p.573
- 3.10 Completion, Takeover and Delivery p.573
- 3.11 Defects and Defects Liability Period p.574

4. Price p.574

- 4.1 Contract Price p.574
- 4.2 Indexation p.574
- 4.3 Payment p.575
- 4.4 Invoicing p.575

5. Time p.575

- 5.1 Planning and Programme p.575
- 5.2 Delays p.575
- 5.3 Remedies in the Event of Delays p.576
- 5.4 Extension of Time p.577
- 5.5 Force Majeure p.577
- 5.6 Unforeseen Circumstances p.577
- 5.7 Disruption p.578

6. Liability p.578

- 6.1 Exclusion of Liability p.578
- 6.2 Wilful Misconduct and Gross Negligence p.578
- 6.3 Limitation of Liability p.579

7. Risk, Insurance and Securities p.579

- 7.1 Indemnities p.579
- 7.2 Guarantees p.579
- 7.3 Insurance p.580
- 7.4 Insolvency p.580
- 7.5 Risk Sharing p.581

8. Contract Administration and Claims p.581

- 8.1 Personnel p.581
- 8.2 Subcontracting p.581
- 8.3 Intellectual Property p.581

9. Remedies and Damages p.582

- 9.1 Remedies p.582
- 9.2 Restricting Remedies p.582
- 9.3 Sole Remedy Clauses p.583
- 9.4 Excluded Damages p.583
- 9.5 Retention and Suspension Rights p.583
- 9.6 Termination p.583

10. Dispute Resolution p.583

- 10.1 Regular Dispute Resolution p.583
- 10.2 Alternative Dispute Resolution p.584

Bae, Kim & Lee LLC was founded in 1980 and is a full-service law firm covering all major practice areas, including corporate law, M&A transactions, dispute resolution (arbitration and litigation), white-collar criminal defence, competition law, tax law, capital markets law, finance, intellectual property, employment law, real estate, technology, media and telecom (TMT), maritime and insurance matters. With more than 650 professionals located across its offices in Seoul, Beijing, Hong Kong, Shanghai, Hanoi,

Ho Chi Minh City, Yangon and Dubai, it offers clients a wide range of expertise through a vast network of offices. The firm is composed of a diverse mix of Korean and foreign attorneys, tax advisers, industry analysts, former government officials and other specialists. A number of its professionals are multilingual and have worked at well-known law firms in other countries, enabling them to assist international clients as well as Korean clients abroad successfully with cross-border transactions.

Authors



Woojae Kim focuses on international arbitration and cross-border litigation, including large-scale construction arbitration cases. He completed his training at the Judicial

Research and Training Institute in 2009, and worked as a judge advocate for three years and as an attorney at Lee & Ko before joining Bae, Kim & Lee in 2013. Mr Kim has handled various construction arbitration cases and advised clients on numerous construction-related claims. He has also represented clients in investor-state disputes and represented clients in a number of international arbitration cases involving general corporate matters, post-M&A and energy issues.



Sangchul Kim is a partner at Bae, Kim & Lee LLC. He has a particular focus on international litigation, overseas legal advice and domestic and international arbitration, with considerable

expertise in the construction, project finance, insurance, nuclear power, semiconductor and pharmaceutical sectors. He is dually qualified as a Korean attorney and a solicitor of England and Wales, and has been involved in contract negotiations and disputes with foreign counterparties across the globe. Mr Kim has authored numerous publications and served on various committees, including as a specialist mediator of the Singapore International Mediation Centre.



Yoon Park enjoys a unique status in the market as one of very few lawyers to have an English law background. Having worked as an in-house counsel at a major shipping company,

she has outstanding knowledge and networks in the shipping and shipbuilding industry. Ms Park has successfully acted for major Korean shipyards/shipowners in many London arbitration proceedings, for foreign insurers/reinsurers in international arbitration and cross-border disputes, and for traders and cargo owners in cross-border disputes. Her expertise also extends to international arbitration and cross-border disputes involving major construction projects around the world, including in Vietnam, the Philippines, Australia and Russia.



Hannah Lee is a foreign attorney at Bae, Kim & Lee LLC, who focuses on complex, large-scale and multi-jurisdictional disputes in a variety of sectors, including onshore construction,

shipbuilding and offshore facilities, marine and insurance, energy and general corporate matters. Prior to joining BKL, Ms Lee worked for the Marine and International Trade Team at Stephenson Harwood LLP (2014–2022), with a particular emphasis on shipping and shipbuilding disputes. She regularly uses her extensive experience to advise Korean and international clients on complex and large-scale construction, shipping and shipbuilding matters, as well as general commercial disputes.

Bae, Kim & Lee LLC

Centropolis B, 26 Ujeongguk-ro
Jongno-gu
Seoul 03161
Korea

Tel: +82 2 3404 0000
Fax: +82 2 3404 0001
Email: bkl@bkl.co.kr
Web: www.bkl.co.kr

bkl BAE, KIM & LEE

1. General

1.1 Governing Law

South Korea is a civil law jurisdiction. As such, it is based on codified laws, and the principal laws governing the construction market in South Korea are as follows (all accessible at www.law.go.kr).

- Various statutes that regulate different aspects of construction and engineering projects, as well as the industry in general.
- The Framework Act on the Construction Industry, the Framework Act on Building, the Construction Technology Promotion Act and the Certified Architects Act, along with certain other statutes, establish standards that participants in the construction industry, such as employers, contractors, construction managers, and architectural design firms, must adhere to in order to operate within the industry. In addition, other acts set standards for specific sectors within the construction industry, including the Electric Construction Business Act, the Fire-Fighting System Installation Business Act, the Engineering Industry Promotion Act and the Information and Communications Construction Business Act.
- The Building Act establishes the requirements for building construction. Local and municipal regulations supplement its provisions by outlining detailed building costs.
- The Housing Act regulates construction, supply, management and transactions in the housing sector. Relatedly, the Housing Site Development Promotion Act specifies special cases for acquiring, developing, supplying and managing housing sites essential for housing construction. In addition, the Act on the Improvement of Urban Areas and Residential Environments focuses on enhancing

urban areas and residential environments through improvement projects.

- The Overseas Construction Promotion Act covers matters concerning Korean construction companies' overseas construction business.
- The Fair Transactions in Subcontracting Act, together with the aforementioned Framework Act on the Construction Industry, governs subcontractor relationships within construction projects. This legislation prioritises the protection and fair treatment of subcontractors, and prevents contractors from imposing unjust terms that jeopardise subcontractors' welfare.
- The Serious Accidents Punishment Act came into effect on 27 January 2022 and imposes extensive health and safety obligations on corporations with 50 or more employees and construction works exceeding KRW5 billion in construction costs.
- The Civil Act outlines the general principles on contract and commercial transactions, and includes sections that govern the relationship between the employer and the contractor. The Commercial Act provides principles on commercial transactions and general principles on corporate matters, including different forms of corporate entities and corporate governance.

1.2 Standard Contracts

In South Korea, various standard forms of contracts are utilised for construction projects. Construction contracts involving the government are governed by the Act on Contracts to Which the State is a Party, and a standard form contract specified in the enforcement rules issued in accordance with the Act is commonly used. In cases where using the standard form is deemed impractical, the government entity has the option to choose a different contract form.

Similarly, a set of standard terms is available for local governments, as outlined in the enforcement rules of the Act on Contracts to Which the Local Government is a Party.

The Ministry of Land, Infrastructure and Transport releases a standard form contract tailored to construction projects involving private sector parties. The Korea Fair Trade Commission also offers a standard form contract for subcontracting within the construction industry.

For larger projects, parties have the flexibility to modify these standard form contracts or to opt for amended versions of internationally recognised contracting forms, such as the FIDIC suite of contracts.

2. Parties

2.1 The Employer

Typically, the employer serves as the primary sponsor and ultimate owner of the project. Employers may be private entities or governmental bodies, including public companies or special purpose companies established for a specific project.

In a typical construction contract, the employer is entitled to receive the finished project in accordance with the specified requirements. In exchange, the employer is responsible for compensating the contractor based on the agreed terms. In addition, the employer is often contractually obliged to secure essential permits and approvals, and to grant site access to the contractor.

The relationships between employer, contractor, subcontractors and financiers are as follows.

- Employers often engage a general contractor to carry out the project. In most cases, a contractor will subcontract some portion of its work to subcontractors or suppliers.
- Private owners typically finance their projects by securing funding from lenders. Depending on the financing arrangement, these lenders may maintain involvement throughout the construction and operation phases of the project to safeguard their investment and ensure the project's successful progression.
- Employers may also engage a construction management firm that will serve only to manage the construction works, without actually carrying out any of the work itself.
- The employer, the contractor or both (depending on the project delivery method) may hire architectural and engineering firms to provide the design for a project.

2.2 The Contractor

In public construction projects, a contractor often takes the form of a joint venture or a consortium, comprising multiple construction companies, whereas in private construction projects, a contractor typically consists of a single construction company. In Korea, there are many internationally recognised construction companies that are also active in the domestic market as contractors. The Korean government strives to provide opportunities for medium-sized construction companies to undertake large-scale projects and other significant ventures, including housing projects.

In a typical construction contract, a contractor is obliged to perform the works in accordance with the contract documents and the relevant laws and regulations, and has the right to receive payment for the works.

Furthermore, as explained in **2.1 The Employer**, a contractor may delegate some portion of its works to a subcontractor.

2.3 The Subcontractors

In South Korea, various types of companies can act as subcontractors in a construction project, including specialised construction firms, electrical and mechanical contractors, architectural firms, suppliers of construction materials, and service providers such as landscaping or interior design companies.

The rights and obligations of subcontractors under a construction contract in South Korea typically include:

- performing the assigned work in compliance with the subcontract specifications, laws and regulations;
- providing labour, materials, equipment and necessary supervision for the completion of their designated tasks;
- adhering to the project schedule and budget agreed upon in the contract;
- ensuring the quality of their workmanship;
- obtaining the required permits and approvals for their scope of work;
- maintaining a safe working environment for their employees;
- co-operating with other project stakeholders and resolving any issues that may arise during the construction process; and
- following the terms and conditions outlined in the subcontract agreement, including payment terms and dispute resolution procedures.

In general, the relationship between subcontractors, the employer, the contractor and the financiers in South Korea is structured as follows.

- Subcontractors work under the direction of the main contractor (or subcontractor if applicable) and are responsible for completing specific portions of the project as outlined in their subcontract agreements.
- The employer retains ultimate ownership and oversight of the project, setting the project requirements and specifications to which subcontractors must adhere.
- The contractor acts as the intermediary between the employer and subcontractors, overseeing the overall project management and co-ordination of subcontracted work.
- Financiers may provide funding for the project and may have a vested interest in ensuring that the project progresses smoothly and meets financial milestones to protect their investment. Subcontractors are typically not directly involved in financial arrangements but are impacted by the project's financial stability and progress.

2.4 The Financiers

In South Korea, various types of companies and institutions can act as financiers in a construction project, including commercial banks, investment banks, private equity firms, government financial institutions, insurance companies and pension funds. These financiers provide funding for construction projects in the form of loans, investments or other financial instruments, subject to the relevant regulations.

Since the promulgation of an act in 1994 aimed at facilitating infrastructure funding through private project financing, the utilisation of project financing has been on the rise in Korea. While large corporations typically opt for bank loans, smaller companies often turn to mutual aid associations established in accordance with the Framework Act on the Construction Industry. These associations provide a range of guar-

antees and loans essential for the operation of construction companies.

The rights and obligations of financiers under a construction contract in South Korea typically include:

- providing funding for the project as agreed upon in the financial arrangement;
- ensuring that the project progresses according to the agreed schedule and budget, to protect their investment;
- receiving repayment of the funds provided, including any interest or returns as specified in the financial agreement; and
- enforcing any security interests or guarantees to protect their investment in case of default.

In general, the relationship between financiers, subcontractors, the employer and the contractor in South Korea is structured as follows.

- Financiers provide the necessary funding for the project and have a financial interest in its successful completion and profitability.
- Subcontractors perform specific tasks within the project and are typically not directly involved in financial arrangements with the financiers.
- The employer oversees the project and sets the project requirements and specifications to which subcontractors and contractors must adhere.
- The contractor manages the overall construction project and co-ordinates the work of subcontractors, ensuring that the project is completed according to the agreed terms and schedule. The contractor may interact with financiers to provide project updates and financial information as required.

2.5 The Designer

In South Korea, various types of companies and institutions can act as designers in a construction project, including architectural firms, engineering firms, design consulting firms and individual design professionals. These designers are responsible for creating the plans, drawings and specifications that guide the construction process and ensure that the project meets the desired aesthetic and functional requirements.

The rights and obligations of designers under a construction contract in South Korea typically include:

- developing detailed design plans and specifications that meet the project requirements and comply with relevant laws and regulations;
- providing accurate and timely design documentation to the employer and contractor for construction purposes;
- collaborating with the employer and contractor to address design-related issues and modifications during the construction process;
- ensuring that the design meets quality and safety standards, and that any changes to the design are properly documented and communicated to all parties; and
- complying with the agreed-upon design schedule and budget.

In general, the relationship between the designer, the employer and the contractor in South Korea is structured as follows.

- The designer works closely with the employer to understand their vision and requirements for the project, and to develop design solutions that meet these needs.

- The designer collaborates with the contractor to ensure that the design is accurately interpreted and implemented during the construction phase.
- The employer relies on the designer to provide design expertise and guidance throughout the project to achieve the desired outcome.
- The contractor follows the design plans and specifications provided by the designer to carry out the construction work according to the agreed-upon design. The contractor may consult with the designer on design-related issues that arise during construction.

3. Works

3.1 Scope

In a construction contract in South Korea, the scope of work is typically established through a comprehensive description of the project requirements, specifications and deliverables. The scope of work may also be defined, expressly or implicitly, by industry standards, codes of practice or other pertinent regulations and requirements to ensure alignment with established norms and quality benchmarks.

3.2 Variations

In South Korea, the determination and limitation of the scope and price for variations in a construction contract – whether requested by the employer or the contractor – are typically governed by the terms and conditions outlined in the contract or by a mutual agreement between the parties. Such terms and conditions are usually not exhaustive as compared to internationally used standard forms of contract, and general principles of the Korean law may apply.

3.3 Design

In a typical construction contract in South Korea, the responsibilities regarding the design process are divided among the employer, the designer, the contractor and other parties involved in the project. The specific allocation of responsibilities varies depending on the project and the contractual terms agreed between the parties.

3.4 Construction

In general, the responsibilities related to the design process are divided among the employer, designer and contractor, with the potential involvement of additional parties based on the project's specific requirements. While the distribution of tasks may vary depending on the type of the construction project and the parties involved, several typical approaches are employed to delineate the division of responsibilities.

- Turnkey or EPC (engineering, procurement and construction) contracts – in these contract types, the contractor assumes full project responsibility, encompassing design, construction and commissioning. The employer typically furnishes project requirements and compensates the contractor upon project completion.
- Construction management (CM) contracts – within CM contracts, the employer oversees project management while the contractor delivers construction services. The contractor typically manages labour, materials and equipment, with the employer supervising construction activities.
- Design-bid-build (DBB) contracts – DBB contracts entail the contractor's responsibility for construction work, with project oversight by the employer.
- Design-build (DB) contracts – under DB contracts, a single entity is contracted to provide

both design and construction services. The contractor ensures project completion in alignment with the employer's requirements and specifications.

- Joint venture (JV) contracts – JV contracts involve collaboration between multiple companies to execute the construction project. Each partner assumes responsibility for their designated work, sharing project risks and rewards.
- Variation/hybrid contracts – besides the above-listed conventional structures, variations and hybrids may exist based on project specifics and the parties involved.

3.5 Site

The responsibility for overseeing the condition of the construction site, including pollution, underground obstacles, geotechnical conditions, archaeological finds and related matters, varies depending on the terms agreed in the construction contract.

Under Korean law, certain regulations govern site conditions, such as:

- the Soil Environment Conservation Act, which addresses the investigation, management and remediation of contaminated soil and groundwater; and
- the Cultural Heritage Protection Act, which regulates the discovery, excavation and preservation of cultural heritage artifacts.

Within construction contracts, the allocation of risk concerning site conditions is typically outlined in the site investigation clause, defining the extent and depth of investigation necessary to evaluate site conditions.

3.6 Permits

In South Korea, various permits must be obtained for different stages and aspects of construction projects, including building permits, approval of construction plans, and use permits. Non-compliance with the relevant regulations can lead to fines and the possibility of imprisonment.

For instance, in the context of building construction, building permits must be secured from the appropriate administrative district prior to commencement, in accordance with Article 11 of the Building Act. Certain exceptions may apply for specific types of construction, as outlined in Article 14 of the Building Act, which includes extensions, repairs and constructions of limited sizes, as well as buildings below a certain size in designated zones.

Upon receiving a building permit, project sponsors are obliged to fulfil various reporting and inspection requirements as construction commences and progresses.

Following completion, a use permit or temporary use permit is necessary to utilise a building as per Article 22 of the Building Act. Any alterations in design or intended use may necessitate reporting the change or obtaining a permit, depending on the extent of the modification, as stipulated in Article 19 of the Building Act.

3.7 Maintenance

Generally, the division of responsibility for maintaining the works varies depending on the terms agreed in the contract. Typically, the contractor is tasked with maintaining the works until the expiry of the defect liability period (DLP), during which time the contractor is obliged to rectify any defects that arise.

Subsequent to the DLP, maintenance responsibility is transferred to the employer or a designated third-party maintenance contractor. Nonetheless, the expiry of the DLP does not absolve the contractor of liability for damages resulting from defective works discovered within the statutory limitations periods, which differ depending on the nature of the works.

Maintenance generally encompasses measures undertaken to preserve the works in optimal condition and address repairs. These actions may involve cleaning, repairing or replacing equipment, systems or components, as well as overall upkeep. The specifics of maintenance works are typically agreed in the construction contract – eg, under provisions for ongoing maintenance and inspections throughout and beyond the DLP.

3.8 Other Functions

In South Korea, functions beyond the core construction activities, such as operation, finance and transfer, may be instructed by the employer to the contractor or third parties, depending on the specific terms and requirements outlined in the contract.

3.9 Tests

Typically, the standard tests for verifying the completion of works may involve visual inspections, functional assessments and performance evaluations, which are tailored to the specific characteristics of the project. A typical sequence of testing is as follows:

- the testing procedure commences with the contractor notifying the employer upon completion of the works;
- subsequently, the employer conducts an inspection to validate whether the works align with the contract terms and relevant laws;

- upon confirmation of compliance, the employer issues a certificate of completion to the contractor; and
- following the issuance of the certificate, additional tests may be conducted to ensure the works' functionality and adherence to standards.

The party responsible for overseeing the testing process is typically determined in the construction contract between the employer and contractor.

3.10 Completion, Takeover and Delivery

The processes of completion and handover of a construction project are closely interlinked and often occur concurrently. The procedures and criteria for completion and handover are usually stipulated in the construction contract. Typically, the completion, takeover and delivery will involve the following:

- **Completion:** this denotes the physical conclusion of the works, signifying that the construction has reached a substantial completion stage. Upon reaching this point, the contractor commonly informs the employer of the works' completion, prompting the employer to conduct an inspection to validate the completion of works.
- **Takeover:** this signifies the transition of risk and accountability from the contractor to the employer. It entails a formal transfer of the completed works along with the associated documentation and information. Typically, the parties execute a takeover certificate to formalise the transfer of responsibility.
- **Delivery:** this involves the transfer of the possession of movable assets from the subcontractor to the contractor. Pursuant to Article 188(1) of the Korean Civil Act, the delivery is

deemed a mandatory condition for the title transfer of movable goods.

3.11 Defects and Defects Liability Period Contractual Remedies for Defects

When defects arise in the construction or design, employers have the option to invoke the DLP clauses in their contract or to pursue damages for non-compliance under the relevant contract law.

Statutory Remedies for Defects

Under Articles 667 and 671 of the Civil Act, employers have the right to demand that contractors repair defects in the work or seek damages instead of repairs. This warranty claim can be made by the employer within five or ten years from the completion of the construction project, depending on the materials used. A contractor for work with respect to land, a building or any other structure shall be liable for any defects in the building or in its foundations for a period of ten years after delivery where the work is made of stone, limestone, brick, metal or any other similar material.

Pursuant to Article 671(2) of the Civil Act, employers must inform contractors of any destruction or damage within one year of its occurrence.

Employers cannot use statutory DLP clauses to claim indirect or consequential damages from contractors, even if contractors could have foreseen such damages. To claim these damages, employers must seek damages separately under Article 390 of the Civil Act, demonstrating that:

- the damages resulted from the contractor's failure to perform;
- the contractor is at fault for the failure; and
- the contractor knew or could have foreseen the circumstances leading to the damages.

4. Price

4.1 Contract Price

In South Korea, the following pricing structures are commonly utilised in construction projects.

- Lump sum: the predominant method is the lump sum contract, entailing a fixed price for the entirety of the construction project. However, the price may be subject to change if there are alterations to the design or if unexpected circumstances arise during the project.
- Unit price: this is often used when quantities of certain items are uncertain.
- Cost plus: this is used when the contractor is reimbursed for actual costs plus a fee, but is not common in Korea.
- Target cost: this is used when parties establish a target cost, motivating the contractor to complete the project within the agreed budget.
- Milestone payments: these are commonly seen in construction contracts in Korea, where payments are made at specific project completion stages. These payments can be based on:
 - (a) the percentage of work completed;
 - (b) the achievement of specific project milestones; or
 - (c) the delivery of designated products.

4.2 Indexation

In construction contracts in South Korea, the indexation of prices is not used as commonly as in some other countries. Instead, parties typically address the risk of large price fluctuations through mechanisms such as:

- fixed price contracts;
- price escalation clauses;
- cost plus contracts;

- target cost contracts; or
- negotiation and risk allocation.

Overall, while the indexation of prices is not as prevalent in construction contracts in South Korea, parties manage the risk of large price fluctuations through various contractual mechanisms, negotiation and risk allocation strategies to ensure cost predictability and project viability.

4.3 Payment

In construction contracts in South Korea, measures to manage late or non-payment, such as additional interest, are typically included to ensure timely and fair compensation for the parties involved. Advanced payments, delayed payments and interim payments are commonly used in construction contracts to facilitate the financial aspects of the project.

It is noteworthy that the Framework Act on the Construction Industry and the Fair Transactions in Subcontracting Act stipulate certain mandatory provisions in relation to the timing of payments.

4.4 Invoicing

Construction contracts in South Korea typically involve monthly or milestone-based invoicing. Invoices usually contain detailed descriptions of the work completed, materials used and expenses incurred during the billing period. In commercial and public projects, contractors often use payment applications for invoicing.

5. Time

5.1 Planning and Programme

In construction contracts in South Korea, planning is typically organised with input from the employer, contractor and other parties. The

employer outlines the project requirements and expectations, while the contractor develops detailed construction plans and schedules. Other parties may provide input or oversight to ensure the project aligns with regulations and standards.

The role of the employer includes setting project objectives, providing necessary information and approving plans. Contractors are responsible for creating detailed construction plans and schedules, and for ensuring work is completed as per specifications. Other parties may contribute expertise to the planning process, such as architects or engineers.

Planning is safeguarded through milestones, milestone payments and certificates. Milestones are key project stages that mark progress, and milestone payments are made upon reaching these stages. Certificates may be issued to verify the completion of milestones or quality standards, providing assurance to all parties involved in the project.

5.2 Delays

In South Korea, parties typically follow a process outlined in the contract to address any delays in construction contracts. The parties involved are expected to notify each other promptly of any delays and work together to mitigate the impact on the project schedule. The contract usually specifies the obligations of each party in the event of delays, such as providing notice, documenting the delay and taking the necessary actions to minimise the delay's effects.

Time-related costs resulting from delays are often addressed in the contract through provisions for liquidated damages or extensions of time. Liquidated damages are predetermined amounts that the party responsible for the

delay must pay as compensation for the delay's impact. Extensions of time allow the contractor additional time to complete the project without facing penalties for delays beyond their control.

Legal and contractual arrangements on concurrent delays address situations where multiple factors contribute to a delay. In such cases, parties may need to assess the impact of each delay factor and determine the appropriate course of action based on the contract terms. Resolving concurrent delays requires careful analysis of the circumstances and adherence to the contract provisions to ensure fair and equitable outcomes for all parties involved.

5.3 Remedies in the Event of Delays

In South Korea, construction contracts usually include liquidated delay damages provisions, which usually fix the rate of damages that would accrue for each day that the completion of the project or a milestone is delayed.

Although the courts generally accept the validity of such provisions, they can reduce the amount of liquidated damages agreed by the parties. Under Article 398(2) of the Civil Act, the court may reduce the amount of liquidated damages agreed by the parties to a more reasonable and appropriate sum if it finds that the amount is "unduly excessive". In practice, the Korean courts often do exercise such power to reduce the amount of liquidated damages.

There is no specific test for determining when agreed liquidated damages may be considered "unreasonably excessive"; the court has discretion and will consider the overall fairness of the contractually stipulated amount of liquidated damages having regard to factors such as:

- the status of the parties;

- the purpose and contents of the contract;
- the reason for pre-determining liquidated damages;
- the ratio of the pre-determined liquidated damages to the contract price; and
- the amount of estimated damages.

As South Korea is a civil law jurisdiction, delay in completion does not, in principle, result in strict liability for failing to meet the required completion date; liability for delay damages will only arise when the delay in completion has been caused by the fault of the contractor. In practice, however, the burden of proving that the contractor was not at fault lies with the contractor and is not readily shifted. As a result, employers do not have to prove fault when raising claims. While parties may in principle agree to impose strict liability obligations in a contract (ie, obligations whose breach does not have to arise out of fault in order to result in liability), the Korean courts will only read such an intention in the parties' contract when it is stated in clear and unequivocal terms, and in such cases are likely to interpret the relevant provisions strictly.

Korean law also recognises the parties' agreement as to penalties for failing to meet contractual obligations. These are generally distinguished from agreed liquidated damages on the basis that they are intended to secure performance of the contract, as opposed to providing a pre-agreed estimate of compensation due in case of a breach of contract.

Penalty provisions may be invalidated (either in full or in part) as being contrary to public policy by the courts if the amount of the penalty is considered to be excessively burdensome compared to the claimant's interest in compelling performance.

Where a penalty provision is upheld, payment of the penalty will be in addition to any compensation for damages, liquidated or otherwise.

Where it is unclear whether certain pre-agreed sums are intended to operate as a penalty or as liquidated damages, the courts will presume that the parties intended the sums to operate as liquidated damages.

5.4 Extension of Time

In South Korea, a contractor typically requests an extension of time in a formal written notice to the employer. The request includes detailed information about the reasons for the delay and the impact on the project schedule, and any supporting documentation or evidence.

Extensions of time are awarded based on valid grounds specified in the contract, such as unforeseen site conditions, changes in the scope of work, delays caused by the employer or other parties, or force majeure events. The contractor must demonstrate that the delay falls within the acceptable grounds for an extension of time as outlined in the contract.

The extension of time is usually established, measured and proven through a thorough analysis of the delay events, their impact on the project schedule, and supporting documentation such as progress reports, correspondence, site records and any other relevant evidence. The contract may outline specific procedures for measuring the extension of time, including the process for submitting and evaluating extension requests and the criteria for granting extensions based on the delay's impact on the project timeline. It is essential for the contractor to provide clear and compelling evidence to support their request for an extension of time.

5.5 Force Majeure

Force majeure events in construction contracts in South Korea typically include unforeseeable circumstances that are beyond the control of the parties and prevent or delay the fulfilment of contractual obligations. Common examples of force majeure events include natural disasters, war, strikes, government actions and epidemics.

In South Korea, it is possible to contractually limit or exclude certain circumstances from being regarded as force majeure events by clearly defining the force majeure event in the contract. Parties can specify the exact events that will be considered as a force majeure event and may exclude events that are within their control or foreseeable at the time of contract formation.

The legal and contractual consequences of force majeure in South Korea may vary depending on the specific terms of the contract. Typically, when a force majeure event occurs, the affected party is excused from performance or may be entitled to an extension of time to fulfil their obligations. In some cases, force majeure may also entitle the parties to terminate the contract without liability for damages resulting from the event. It is important for parties to carefully review and understand the force majeure clause in the contract to determine their rights and obligations in the event of a force majeure event.

5.6 Unforeseen Circumstances

In construction contracts in South Korea, the treatment of unforeseen circumstances is typically addressed through a combination of mandatory or regulatory laws and contractually agreed-upon terms between the parties. Mandatory or regulatory laws may provide general guidelines or principles regarding unforeseen circumstances, while specific provisions related

to unforeseen events are often contractually agreed upon by the parties in the contract.

Contractual agreements between the parties play a significant role in determining how unforeseen circumstances are addressed in construction contracts in South Korea. Parties have the flexibility to define the scope of unforeseen circumstances, establish procedures for addressing such events, and allocate risks associated with unforeseen events through contractual provisions such as force majeure clauses, change order provisions and dispute resolution mechanisms.

The contract may include provisions that outline the process for identifying, notifying and responding to unforeseen circumstances, as well as mechanisms for adjusting the contract terms, schedule and costs in response to such events.

Moreover, the Civil Act stipulates that if an unforeseeable event beyond the obligator's control renders the performance of an obligation impossible, the obligation is considered extinguished.

5.7 Disruption

In South Korea, disruption is commonly recognised as a valid legal and contractual ground for seeking an extension of time and/or compensation in construction contracts. Disruption refers to events or circumstances that impede the progress of work, leading to delays or increased costs beyond what was originally anticipated. Parties may be entitled to compensation for additional time and costs incurred due to disruptions that impact the project schedule or productivity.

Disruption is typically established, measured and proven through a detailed analysis of the impact on the project. This may involve documenting the specific causes of disruption, quantifying the resulting delays or inefficiencies, and providing evidence to support the claim for an extension of time or compensation. Documentation such as daily reports, progress records, correspondence and expert assessments may be used to demonstrate the effects of disruption on the project.

Parties may need to show a causal link between the disruption events and the resulting delays or costs to substantiate their claim. By effectively establishing and proving disruption, parties can seek appropriate remedies in accordance with the contract terms and applicable laws to address the impact of unforeseen events on the construction project.

6. Liability

6.1 Exclusion of Liability

In principle, parties to a contract may exclude or limit their liability under contract or tort, provided that doing so is not contrary to any laws or public policy. By way of example, in the case of liability in tort, parties cannot agree to limit or exclude liability arising from intentional breach, wilful misconduct or gross negligence, as such agreement will be deemed contrary to public policy.

6.2 Wilful Misconduct and Gross Negligence

The concepts of wilful misconduct and gross negligence exist in South Korea. Under Korean law, a “grossly negligent act” (*Junggwasil*) refers to an easily foreseeable and avoidable action that is conducted without exercising even a minimal level of care. These concepts are rec-

ognised and governed by the legal framework in South Korea.

6.3 Limitation of Liability

In principle, parties to a contract may exclude or limit their liability under contract or tort, provided that doing so is not contrary to any laws or public policy.

7. Risk, Insurance and Securities

7.1 Indemnities

In South Korea, indemnities are commonly used in construction contracts to limit risk and allocate responsibilities between the parties involved in the project. Indemnities serve as a contractual protection mechanism where one party agrees to compensate the other party for specific losses, damages or liabilities that may arise during the course of the construction project.

Typical subjects for which one party would indemnify another in a construction contract in South Korea may include the following.

- Third-party claims: one party may indemnify the other against any claims or lawsuits brought by third parties, such as subcontractors, suppliers or other stakeholders, arising from the construction activities.
- Bodily injury or property damage: the indemnifying party may agree to indemnify the other party for any bodily injury or property damage caused by the indemnifying party's actions or negligence during the construction project.
- Non-compliance with laws and regulations: one party may indemnify the other for any losses or penalties resulting from non-compliance with applicable laws, regulations or building codes during the construction process.

- Design defects or errors: the indemnifying party may agree to indemnify the other party for any losses or damages caused by design defects, errors or omissions in the construction plans or specifications.
- Delay or disruption claims: indemnities may cover claims related to project delays, disruptions or additional costs incurred due to causes within the control of one party.

By including indemnity provisions in construction contracts, parties can allocate risks more effectively and ensure that they are protected against potential liabilities that may arise during construction projects in South Korea.

7.2 Guarantees

Korean construction projects will usually involve the employer requiring several types of security from contractors, usually in the form of on-demand bonds. These include the following.

- Bid bonds guaranteeing that a successful bidder will enter a contract with the employer. These usually expire once the contract for the project is executed.
- Performance bonds guaranteeing that the contractor will fulfil its obligation to progress and complete the construction. These usually expire after the completion of the project. In some cases, they may be extended in part to cover any punch-list items or defect liability periods.
- Advance payment bonds issued by the contractor to the employer, to secure any cash payments made by the employer to the contractor as mobilisation advance. These bonds are amortised to reflect the repayment of the advance through deductions from progress payments due to the contractor.
- Maintenance bonds against guarantees that the contractor will repair any defects in the

works after completion. Their duration often reflects the contractual defect liability period or the statutory liability periods.

- Subcontractor's payment bonds that secure payments due to subcontractors in cases where a contractor cannot pay due to insolvency or other causes (Article 34(2) of the Framework Act on the Construction Industry).

7.3 Insurance

In South Korea, parties are required to take out Industrial Accident Compensation Insurance under the Industrial Accident Compensation Insurance Act. In most cases, employers will also hold liability insurance to cover compensation liabilities exceeding the amount coverable by the Industrial Accident Compensation Insurance.

Parties will typically obtain the following other types of insurance:

- construction all risks insurance, which insures against physical damage to the works or materials;
- cargo insurance, which insures against risks such as damage to materials during transportation from overseas;
- professional indemnity insurance, which insures against claims related to the design of the project;
- Workmen's Compensation Insurance, which compensates death or injury caused to workers to the extent not covered by the Industrial Accident Compensation Insurance;
- Package Insurance, which covers any potential business interruption risk; and
- commercial general liability insurance, which covers damages to third parties.

7.4 Insolvency

In a construction contract in South Korea, contractual provisions regarding the consequences of the insolvency of a party to the contract play a crucial role in managing risks and ensuring the continuity of the project in case of financial difficulties. These provisions typically address the following aspects.

- Termination rights: the contract may specify the rights of the non-insolvent party to terminate the agreement in the event of the other party's insolvency. Termination clauses may outline the procedures and consequences of termination due to insolvency. However, if rehabilitation or bankruptcy proceedings have been commenced, the exercise and recognition of these termination rights are subject to the provisions of the Debtor Rehabilitation and Bankruptcy Act.
- Continuation of work: provisions may address how the work will continue in the event of a party's insolvency. This could involve appointing a new contractor to complete the work or restructuring the project to ensure its completion.
- Payment and performance bonds: the contract may require the insolvent party to provide payment and performance bonds to secure payments to subcontractors and suppliers, and to ensure the completion of the project despite the insolvency.
- Assignment of rights and obligations: the contract may include provisions allowing for the assignment of rights and obligations to a third party in the event of insolvency, to ensure the project's continuity.
- Resolution of disputes: provisions may detail the process for resolving disputes related to the insolvency of a party, including mechanisms for arbitration or mediation.

These provisions may vary depending on the parties involved in the construction contract. For example, the consequences of insolvency may differ for the main contractor, subcontractors, suppliers or other stakeholders based on their roles and responsibilities in the project. Each party's rights and obligations in case of insolvency are typically outlined in the contract to ensure clarity and mitigate risks associated with financial instability.

7.5 Risk Sharing

In South Korea, the sharing of responsibility for certain risks is a common practice in construction contracts to allocate risks among the parties involved in the project. Risk sharing helps to distribute potential liabilities and uncertainties in a fair and balanced manner.

Construction contracts in South Korea arrange for risk sharing through various mechanisms, including the following.

- Indemnification clauses: parties may agree to indemnify each other for specific risks or liabilities that may arise during the project.
- Insurance requirements: contracts may stipulate insurance requirements to cover certain risks, with the cost of insurance premiums shared between the parties.
- Change order procedures: contracts may outline procedures for addressing changes in the scope of work, design modifications or unforeseen conditions, with the associated risks shared accordingly.
- Dispute resolution mechanisms: contracts may include provisions for resolving disputes related to shared risks through negotiation, mediation or arbitration.

Shared risks in construction contracts are generally priced based on factors such as the likeli-

hood and impact of the risk, the cost of mitigation measures, insurance premiums and industry standards. Pricing for shared risks may involve allocating costs proportionally based on the parties' responsibilities or negotiating specific terms for risk sharing and cost allocation.

By clearly defining shared risks, responsibilities and pricing mechanisms in construction contracts, parties can effectively manage uncertainties, promote collaboration and ensure the successful completion of construction projects in South Korea.

8. Contract Administration and Claims

8.1 Personnel

Construction contracts commonly contain contractual provisions related to the personnel involved in the construction project. These provisions are designed to ensure proper staffing and personnel management to facilitate the successful completion of the project. The specific details of these provisions may vary based on the project's characteristics and intricacies.

8.2 Subcontracting

Subcontracting is a prevalent practice in the South Korean construction sector, and construction contracts commonly incorporate clauses related to subcontracting. Nonetheless, this practice is bound by specific restrictions and requirements. Notably, the Framework Act on the Construction Industry establishes a set of prohibitions and guidelines to promote equitable and transparent subcontracting practices.

8.3 Intellectual Property

In South Korea, construction contracts frequently incorporate clauses related to intellectual

property to regulate the ownership, utilisation and safeguarding of IP rights within the project.

9. Remedies and Damages

9.1 Remedies

In South Korea, various remedies are available for the different parties involved in a construction contract in the event of a breach. Common remedies for the key parties include the following.

- For the employer:
 - (a) termination of contract;
 - (b) claim for damages; and
 - (c) specific performance.
- For the contractor/designer:
 - (a) termination of contract;
 - (b) claim for payments/damages; and
 - (c) suspension of works.

9.2 Restricting Remedies

In South Korea, it is common practice to contractually limit the remedies available to a party. Parties often include provisions in the contract that specify the extent to which remedies can be limited in case of a breach. Common limitation/exclusion provisions include the following.

- Limitation of liability:
 - (a) parties may agree to limit the liability of one party in case of breach or non-performance – this limitation can cap the amount of damages that can be claimed by the non-breaching party; and
 - (b) the limitation of liability clause typically specifies the maximum amount that can be recovered in case of a breach, which helps to manage the financial risk for both parties.
- Exclusion of certain remedies:

- (a) construction contracts may exclude certain remedies that would otherwise be available under the law – eg, parties may agree to exclude punitive damages or specific performance as remedies for breach; and
 - (b) by excluding certain remedies, parties can streamline the dispute resolution process and avoid prolonged litigation over specific types of remedies.
- Time limits for seeking remedies:
 - (a) contracts may include provisions that set time limits for parties to seek remedies in case of a breach – failure to adhere to these time limits may result in the loss of the right to pursue certain remedies; and
 - (b) time limits provide clarity and certainty regarding the timeframe within which parties must act to enforce their rights under the contract.
 - Mandatory dispute resolution mechanisms:
 - (a) construction contracts often include mandatory dispute resolution mechanisms, such as arbitration or mediation, which can limit the remedies available to parties; and
 - (b) parties may agree to resolve disputes through these alternative mechanisms, which may restrict the types of remedies that can be sought compared to traditional litigation.

Overall, the extent to which remedies can be contractually limited in construction contracts in South Korea depends on the specific terms negotiated by the parties. It is essential for parties to carefully review and understand the limitations on remedies outlined in the contract to ensure clarity and fairness in the event of a breach.

9.3 Sole Remedy Clauses

Contractual sole remedy clauses are commonly used in construction contracts in South Korea, and their enforcement requires clear drafting, mutual agreement, compliance with legal requirements, and potential judicial enforcement in case of a dispute.

9.4 Excluded Damages

In South Korea, construction contracts may exclude certain forms of damages from liability through contractual provisions. Common forms of damages that are typically excluded from liability in construction contracts include:

- consequential damages;
- punitive damages; and
- incidental damages.

9.5 Retention and Suspension Rights

In South Korea, retention and suspension rights are generally not contractually excluded in construction contracts.

9.6 Termination

In South Korea, parties have the freedom to negotiate and define the terms of termination in their contracts. The level of specificity in outlining the grounds for termination may vary depending on the circumstances of each case. Courts generally uphold termination provisions that are fair and do not violate public policy. Consequently, parties can typically include provisions that allow the employer to terminate the contract for convenience or permit either party to terminate in cases of prolonged force majeure events.

In addition to the agreed-upon termination terms, the Civil Act sets out specific situations in which a party may terminate a contract. Generally, if there is a delay in fulfilling a contractual obligation that remains unremedied or cannot

be remedied, the non-breaching party may terminate the contract.

In the context of a construction contract involving a completed building or structure, defects in the work do not automatically grant the right to termination. In such instances, the contractor is responsible solely for damages resulting from the defects.

Furthermore, according to the Civil Act, if circumstances beyond the control of the parties make it impossible for the contractor to fulfil their obligations, the contractor will not be held liable for non-performance, and the employer will be released from the obligation to pay for incomplete work. In this scenario, the contractor is not liable for damages resulting from the inability to perform. However, under Korean law, such impossibility does not necessarily grant the right to terminate the contract. Therefore, it is advisable for parties to explicitly agree on the right to terminate in cases of prolonged force majeure events where desired, considering the distinctions between situations of impossibility and those that qualify as conventional force majeure events.

10. Dispute Resolution

10.1 Regular Dispute Resolution

In South Korea, a significant number of domestic construction and engineering disputes are typically resolved through court litigation. Some district courts and high courts have specialised divisions dedicated to handling construction and engineering disputes.

Korean courts are known for efficiently processing construction and engineering disputes. With specialised court divisions focusing on con-

struction and engineering matters, disputes in the construction industry are managed with a high level of expertise and effectiveness. Generally, a construction and engineering litigation case at the first instance court may take around 12 to 18 months, although in certain instances the process may extend to approximately two years.

10.2 Alternative Dispute Resolution

In addition to court litigation, various laws provide for alternative dispute resolution methods to address construction disputes. For example, Article 69 of the Framework Act on the Construction Industry establishes the Construction Dispute Mediation Committee for resolving construction and engineering disputes through mediation. Parties also have the option to pursue court-administered mediation.

Arbitration is increasingly favoured by local parties as a preferred method of dispute resolution. The Korean Commercial Arbitration Board frequently handles a substantial number of construction and engineering disputes through arbitration each year.

Korean construction companies engaged in international projects are well versed in utilising arbitration for resolving construction disputes, particularly those of an international nature. Arbitration is often the preferred choice for resolving disputes in cross-border construction projects due to its efficiency and effectiveness in providing a neutral and enforceable resolution.

SWEDEN



Law and Practice

Contributed by:

Daniel Prawitz, Julia Ahlqvist and Clara Klingspor
Advokatfirman Vinge KB

Contents

1. General p.588

- 1.1 Governing Law p.588
- 1.2 Standard Contracts p.588

2. Parties p.589

- 2.1 The Employer p.589
- 2.2 The Contractor p.590
- 2.3 The Subcontractors p.590
- 2.4 The Financiers p.590
- 2.5 The Designer p.591

3. Works p.591

- 3.1 Scope p.591
- 3.2 Variations p.592
- 3.3 Design p.592
- 3.4 Construction p.593
- 3.5 Site p.593
- 3.6 Permits p.594
- 3.7 Maintenance p.594
- 3.8 Other Functions p.594
- 3.9 Tests p.594
- 3.10 Completion, Takeover and Delivery p.594
- 3.11 Defects and Defects Liability Period p.595

4. Price p.596

- 4.1 Contract Price p.596
- 4.2 Indexation p.596
- 4.3 Payment p.596
- 4.4 Invoicing p.596

5. Time p.597

- 5.1 Planning and Programme p.597
- 5.2 Delays p.597
- 5.3 Remedies in the Event of Delays p.597
- 5.4 Extension of Time p.597
- 5.5 Force Majeure p.598
- 5.6 Unforeseen Circumstances p.598
- 5.7 Disruption p.599

6. Liability p.599

- 6.1 Exclusion of Liability p.599
- 6.2 Wilful Misconduct and Gross Negligence p.600
- 6.3 Limitation of Liability p.600

7. Risk, Insurance and Securities p.600

- 7.1 Indemnities p.600
- 7.2 Guarantees p.600
- 7.3 Insurance p.600
- 7.4 Insolvency p.601
- 7.5 Risk Sharing p.601

8. Contract Administration and Claims p.601

- 8.1 Personnel p.601
- 8.2 Subcontracting p.601
- 8.3 Intellectual Property p.602

9. Remedies and Damages p.602

- 9.1 Remedies p.602
- 9.2 Restricting Remedies p.603
- 9.3 Sole Remedy Clauses p.603
- 9.4 Excluded Damages p.603
- 9.5 Retention and Suspension Rights p.603
- 9.6 Termination p.604

10. Dispute Resolution p.604

- 10.1 Regular Dispute Resolution p.604
- 10.2 Alternative Dispute Resolution p.604

Advokatfirman Vinge KB is a leading Nordic full-service law firm, with 500 expert employees and offices in Stockholm, Gothenburg, Malmö, Helsingborg and Brussels. Vinge is a full-service firm with practices within international trade, corporate law, M&A, capital markets, dispute resolution, IP, public procurement, employment, transport, environmental law, real estate, and construction. Vinge's client base encompasses domestic and international businesses and organisations, including private equity firms, government entities, start-ups and entrepreneurs.

With regard to the firm's construction practice, in particular, it is standalone – with approximately 25 lawyers (including five partners) working with contentious and non-contentious matters. The firm's construction practice client base includes several of Sweden's largest contractors as well as private real property developers. The practice also regularly advises in connection with the procurement of construction services for renewable energy projects. The firm continuously achieves Tier 1 rankings in most fields within Chambers' yearly rankings.

Authors



Daniel Prawitz is a partner at Advokatfirman Vinge KB and co-heads the firm's construction practice. Daniel advises project developers and contractors in day-to-day matters during the

tender phase, production phase and post-completion phase within a broad range of project types. He is specialised, however, in large infrastructure projects and dispute resolution, having acted as lead counsel and co-counsel to domestic and foreign contractors in several of the largest infrastructure disputes in Sweden during recent years. Previous experience as in-house legal counsel for one of Sweden's largest construction and infrastructure companies has given him deep industry experience and insight beyond the strictly legal aspects in connection with various projects.



Julia Ahlqvist is a senior associate at Advokatfirman Vinge KB and a member of the Swedish Bar Association, specialising in construction law and dispute resolution. Julia

regularly assists Swedish and international clients in day-to-day matters related to the construction industry and represents clients in both litigation and arbitration disputes. Her experience includes acting as co-counsel in several large infrastructure disputes against the Swedish Transport Administration Authority.



Clara Klingspor is an associate at Advokatfirman Vinge KB with a primary focus on construction law and public procurement. Clara provides advice on regulatory compliance, appeal

procedures, contract negotiations, and dispute resolutions. In addition, she has extensive experience of acquisitions and divestments of companies and assets within the construction industry.

Advokatfirman Vinge KB

Östergatan 30
PO Box 4255
SE-203 30 Malmö
Sweden

Tel: +46 10 614 5500
Fax: +46 10 614 3190
Email: contact@vinge.se
Web: www.vinge.se

VINGE

1. General

1.1 Governing Law

Commercial construction agreements are not governed by any specific legislation. Instead, they rely on standard contracts that have the status of agreed documents. Construction agreements where the employer is a consumer is governed by the Consumer Services Act (1985:716).

The Swedish Planning and Building Act (2010:900) and its associated ministerial orders primarily regulate statutory requirements for building and construction.

Additionally, the Contracts Act (2015:218) may be applied with regard to the invalidity or adjustment of a commercial construction agreement with reference to, for example, unreasonably burdensome contract provisions. Finally, following judgments from the Supreme Court in recent years, the and the Sale of Goods Act (1990:931) may be used to a certain extent in the interpretation of construction agreements.

1.2 Standard Contracts

The use of standard contracts is industry standard in the Swedish construction industry – both

for small and larger constructions, and irrespective of project type. However, the use of standard contracts is not mandatory. Although they embody Swedish legal principles to a degree, their application is contingent upon mutual agreement by the contracting parties.

The Swedish so-called AB Standards are the result of negotiations within the Construction Contracts Committee (*Byggandets Kontraktsskommitté*, or BKK), which is a non-profit organisation constituted by various interest groups in the Swedish construction industry. The Construction Contracts Committee is responsible for the publishing of the key standard construction contracts used on the Swedish market, as follows.

- AB 04 – outlines the general conditions for building and civil engineering works and building services when the employer oversees design and planning, leaving execution to the contractor. In the agreement between the main contractor and its subcontractors, AB-U 07 shall be agreed as an add-on agreement to AB 04. AB 04 bears many similarities to the International Federation of Consulting Engineers (*Fédération Internationale des Ingénieurs - Conseils*, or FIDIC) Red Book,

although there are also several key differences.

- ABT 06 – sets the conditions for design-and-build contracts where the contractor assumes responsibility for both the design and the construction of the project. In the agreement between the main contractor and its subcontractors, ABT-U 07 shall be agreed as an add-on agreement to ABT 06. ABT 06 bears many similarities to the FIDIC Yellow Book, although (as with AB 04) there are also several key differences.
- ABK 09 – specifies the general conditions for consultancy services in architectural and engineering assignments, defining the relationship and responsibilities between an employer/contractor and its consultant. ABK 09 may be viewed as a Swedish version of the FIDIC White Book, although there are several important differences here as well.
- ABM 07 – specifies the general conditions of contract for the procurement of goods and materials to be used in a construction project, and is used between contractors and their suppliers. In contrast with the above-mentioned other standard contracts (ie, AB 04, ABT and ABK 09), ABM 07 replaces and supplements Swedish law in the form of the Sale of Goods Act (1990:931), which would be applicable to such agreement in the absence of agreed specific terms.
- ABA 99 – specifies the general conditions for the supply of industrial works in major production facilities and may be used in a range of different types of projects. ABA 99 is often agreed in connection with the delivery and installation of wind turbines and other types of electrical power plants, waste and sewage handling facilities, warehouse or industry automations and other similar production facilities with a focus on capacity and availability. ABA 99 is not a part of the AB Stand-

ards negotiated and agreed by the Construction Contracts Committee. Instead, ABA 99 is a non-negotiated document published by the Technology Industries of Sweden (*Teknikföretagen*), an industry association for suppliers of various types of technology-based products and facilities. However, despite being a non-negotiated document, ABA 99 is widely used, whereby the employer/customer would normally specify its project specific amendments to ABA 99.

2. Parties

2.1 The Employer

In Sweden, a diverse range of entities serve as employers for construction projects. These include the Swedish state or state-controlled entities, regional authorities, municipalities, the private sector (including institutional investors such as pension funds), and housing co-operatives.

Employer's Rights and Obligations

Typically, the employer is responsible for:

- providing the contractor with the basis for tender;
- providing payment/security/insurance to the contractor;
- securing necessary construction approvals; and
- arranging the inspection of the contract works.

The employer is typically given various supervisory and regulatory duties and privileges in relation to the contractor. This includes, inter alia, the right to:

- terminate the contract for the remaining works under certain circumstances, such as significant delay, defective work, insolvency, or force majeure;
- cancel parts of or the contract works in their entirety at the employer's discretion – in which case, the contractor is entitled to certain compensation according to the agreement; and
- compensation for loss due to the contractor's negligence, delay, omission, or defects.

2.2 The Contractor

The contractors in Swedish construction projects can be categorised into two main types:

- general contractors – larger construction groups that handle comprehensive general contracts (ie, taking full responsibility for all other contractors/consultants in the project), often on a design-and-build basis; and
- specialised contractors – contractors that focus on specific construction areas and often work as subcontractors to a general contractor (eg, various installation companies).

Contractor's Rights and Obligations

A contractor's primary role involves the planning and execution of construction works. It typically has the autonomy to decide on the methods of construction, unless specified otherwise in the agreement. Other key responsibilities include:

- supplying materials;
- providing, and during the liability period maintain, relevant security and insurances; and
- creating and maintaining time schedules.

Some of the contractor's rights, among others, under the AB standards are the right to:

- carry out alterations and additions prescribed by the employer; and
- cancel the contract or suspend the works in the event of the employer's failure to fulfil its obligations, provide adequate surety, or become insolvent, among other reasons.

2.3 The Subcontractors

The subcontractors in Swedish construction projects often have expertise in niche domains – notably, in technical services such as ventilation, plumbing and electrical works or various types of ground works. However, subcontractors to general contractors could also have a broader expertise.

The main contractor in a construction project acts as an employer to its subcontractors, mirroring the contractor's own relationship with the employer. This parallel establishes similar rights and obligations for subcontractors as those held by the contractor. However, to avoid, for instance, identical notice periods, the main contractor is advised to include AB-U 07 or ABT-U 07 in its subcontractor agreement – the use of which helps the main contractor to avoid being “stuck in the middle” between the rights and obligations towards its employer and what it may require, or ultimately demand, from its subcontractor.

2.4 The Financiers

Construction projects where the employer is a private entity are typically funded by private banks. These financiers maintain separate contractual agreements with the involved parties to whom they grant financing – although they are not granted any inherent rights or duties within the construction agreement itself or towards any other party in the project, unless explicitly stated in said agreement.

Such inherent rights are in practice customary where the project developer's finance provider will normally retain a step-in right to be able to finish a project for which it has provided financing.

2.5 The Designer

The designer in Swedish construction projects is often a consultant specialised in design and constructions (ie, an architect firm or an engineering company). These are normally contracted by the employer in a build-only project where AB 04 is the agreed standard agreement and by the contractor in design-and-build projects where ABT 06 is the agreed standard agreement. The employer/contractor is advised to include ABK 09 as the applicable standard agreement in its contract with its consultants. Please refer to 3.3 Design for more information on the relation between the designer, the employer and the contractor.

In general, the main obligations of the designer under ABK 09 are to perform the execution of the assignment on time and subscribe for (and, during the liability period, maintain) relevant insurance. On the other hand, the consultant is entitled to reasonable remuneration for the work performed and the costs incurred, as well as for any changes or additional work. It is important to be aware of the fact that ABK 09 limits the consultant's liability under the agreement to a sum equivalent to 120 so-called price base amounts, which for 2024 corresponds to approximately USD600,000. Project-specific increases of said limitation may often be advisable.

3. Works

3.1 Scope

The scope of the contract works is determined by the contract documents, which include contract, basis for tender, technical specifications and descriptions, drawings, bill of quantities, and any other documents that show the agreement of the parties and the intended final result of the project, and which have been referred to in the main contract. This fundamental principle follows explicitly from AB 04/ABT Chapter 1 Section 1 and, in addition to regulating what work is included in the scope of works, it also dictates what works are excluded from the contractor's obligations (ie, any work not specified in the contract documents). However (and as an exception to this rule), if the contractor is responsible for the design work and ABT 06 is agreed, the contractor's obligations include not only what is described in the contract documents but also what is required by the intended use of the completed project as explained to the contractor by the employer. This is described as a "functional responsibility" for the intended use of the works.

So-called partnering projects, where the employer and the contractor jointly decide on the design and pricing of the works to be performed, are becoming increasingly popular in the Swedish market. In these cases, the intention is that the parties shall benefit from both parties' experiences and competence in order to optimise the design, the production and the price. However, the general principle of how the scope of work is determined (as described earlier) will still apply and, in these cases, the parties are advised to be extra meticulous when specifying the works to be performed and who of the parties is responsible for different parts of the design, etc.

3.2 Variations

Variations Requested by the Employer

Under the AB Standards, employers may request work variations directly connected to the contract works. Variations can include additional or alternative services, or changes in service nature, quality, type or execution. Contractors are entitled to execute and be compensated for employer-requested variations, and the employer may not engage another contractor to engage such variations, as the right to performance of such works may be a part of the contractor's assumptions when determining the price offered.

In addition, the employer has the right to order variations in the form of a reduction of the scope of works.

Variations Requested by the Contractor

Additional works that need to be executed in order for the contractor to be able to deliver the contract works could in some events be considered equivalent to variations ordered by the employer, even if not ordered – for example, if the basis for the tender is incorrect or if the site or other circumstances differs from what could be assumed at the time of tender. If the construction agreement is based on ABT 06, equivalent variations must be notified to the employer without delay. Subsequent to such notice, the contractor may (and must) proceed with the planning and execution of such variations. In AB 04 contracts, the contractor must obtain the employer's views without delay – after which, the employer decides what variations shall be ordered and executed. The reason for the different regulation in AB 04 and ABT 06 contracts is related to where the responsibility for the design normally lies.

Price Determination

The contractor is entitled to additional compensation for ordered or correctly notified variations of the contract works that are needed. The value of work added shall be calculated primarily on unit prices (if such have been agreed on) and otherwise determined in accordance with the prime cost principle (cost plus overheads and profit) as specified in the AB Standards. If a variation reduces costs, the employer may be eligible for a price deduction.

Time-Related Costs

As part of the variation work, the contractor is normally entitled to any time-related costs (eg, for a prolonged establishment at the work site). However, in practice, it is not uncommon that the parties disagree on this matter, as the contractor may often not be able to determine whether a variation will affect the production time required until several variations combined entail a requirement to postpone the contract period. In such cases, the contractor should request compensation for such costs as a result of the various variations.

3.3 Design

The responsibility for the completion of design works is primarily decided by whether the employer procures the project as a build-only project (for which AB 04 would normally be agreed) or a design-and-build project (for which ABT 06 would normally be agreed).

In the first situation, the responsibility to procure and provide all design works lies with the employer. In the latter situation, the responsibility to procure and provide the final building design lies with the contractor.

In both cases, the employer or the contractor respectively would normally fulfil its design obli-

gations by way of contracting a range of consultants (where ABK 09 would be agreed), and the consultant will be liable for the correctness of its design in relation to the party who appointed it.

3.4 Construction

The employer is responsible for preparing the basis of the tenders. The employer can choose either:

- to contract one main contractor in a general contract, entailing that such contractor in turn would have to contract subcontractors to perform the total works; or
- to divide the project into several different contracts with several contractors – all of which report directly to the employer and without any direct contractual link between the different contractors.

Regardless of which model is used, the agreements with the one main contractor or the several contracts with the several different contractors can be in the form either a build-only contract (incorporating AB 04) or a design-and-build contract (incorporating ABT 06).

Please refer to **2.1 The Employer**, **2.2 The Contractor** and **2.3 The Subcontractors** for a general description of the rights and obligations of the employer, the contractor, the subcontractors.

3.5 Site

Information Regarding the Site

Unless otherwise agreed between the parties, the employer is assumed to have given all relevant information that can be obtained from expert inspection of the property or area affected by the construction. However, the AB Standards include a golden principle entailing that the responsibility for the correctness of data, results of investigations and technical solutions

will always rest with the party that has provided them and that the approval of the other party of such documents, data, information, etc., will not limit this.

Normally, the employer will provide information, investigations, etc., regarding geotechnical conditions or underground obstacles to the extent known to the employer – usually as a result of geotechnical surveys. However, to the extent that such information is not provided in the tender documents or the information is insufficient to draw any comprehensive conclusions, the contractor shall calculate based on such conditions and costs that may be assumed following the contractor's "workman-like determination". The Supreme Court has – through its judgment NJA 2005 p 3 (the so-called Gotland case) – explained how the contractor should act in these situations.

Work Environment

According to mandatory rules under the Work Environment Act (1977:1160), the employer is responsible for ensuring that work performed is performed in a safe manner and in accordance with the work environment regulations applicable by law. Normally, the employer will delegate this responsibility to the contractor in the construction agreement, as it is the contractor who would normally have the best options to ensure compliance. However, certain parts of the work environment responsibilities may never be delegated in relation to the public authorities. This means that, even though the employer may have delegated the work environment responsibilities to the contractor between the parties, it is not possible to fully delegate the ultimate responsibility – and consequently such criminal liability that may follow from mandatory legislation – in relation to the authorities. Hence, the employer

may in certain cases be held responsible by the authorities for omission on part of the contractor.

Authority Interventions

Authorities have the power to intervene with enforcement notices or prohibitions if the site fails to meet legal standards (eg, those pertaining to pollution) or if archaeological discoveries are made. The risk for any such interventions lies with the employer, except when they arise as a result of the contractor's actions.

3.6 Permits

Construction projects typically need a building permit from the local municipality, based on the employer's application. This permit is mandatory and, in some cases, a filing may be necessary even without the need for a permit. Additionally, construction sites may require a time-limited permit for elements such as headlights, fences, and signs.

The employer must notify the Swedish Work Environment Authority and the Swedish Tax Agency Construction upon establishing the construction site. Obtaining confirmation from these authorities is a prerequisite for starting construction activities. Often, this responsibility is delegated to the contractor. However, as mentioned in 3.5 Site, it must be noted that this is a responsibility in relation to the public – meaning that it will ultimately always be the employer's responsibility in the event of any omissions.

3.7 Maintenance

It is the contractor's duty to maintain and secure the works throughout the construction period (ie, until the total works are approved and handed over to the employer at final inspection). The contractor holds the risk for any damage or loss of the works and materials until the project is officially transferred to the employer. Post-handover,

the employer assumes all responsibility for the maintenance of completed works, unless otherwise agreed explicitly – for example, by prescribing that the contractor must perform yearly maintenance inspections during the warranty period and perform such yearly maintenance as may be required according to the maintenance plan.

3.8 Other Functions

Typically, the employer does not direct the contractor or third parties to manage operations, finance, transfer or other functions during the construction process.

3.9 Tests

Inspections can be requested by the parties, and the other party or an appointed inspector can assess the compliance, completion and quality of the contract works. The inspections available include pre-inspection, final inspection, guarantee inspection, special inspection, re-inspection, and arbitration inspection – each with its own conditions, timing, and effects as stipulated in the AB Standards AB 04 and ABT 06.

To the extent any functions with regard to the works are to be tested, it is the employer by way of its appointed inspector or inspection organisation who is responsible for such testing.

The correct completion of the total works is assessed at the final inspection, as further detailed in 3.10 Completion, Takeover and Delivery.

3.10 Completion, Takeover and Delivery

A final inspection must be carried out, unless otherwise agreed by the parties, in connection with the expiry of the contract period. The final inspection shall be concluded with a meeting at which the inspector shall hand down their decision on whether the total works are deemed

approved or not. Upon approval at final inspection, the total works are deemed handed over – in connection with which a number of legal consequences occur as, for example, the start of the warranty period and the start of a number of deadlines begin to run.

A party is entitled to request final inspection of a completed part of the total works if the employer starts using or requests to start using that part.

A party who is dissatisfied with the result of a final inspection may request an arbitration inspection where the conclusions made in connection with the final inspection are to be reconsidered by an arbitration inspector or a tribunal of three arbitration inspectors. It shall be highlighted that although the phrase “arbitration” is used, it is not a formal arbitration in the form of dispute resolution. The decision of the arbitration inspector or tribunal of arbitration inspectors is not binding unless the parties agree otherwise, and the decision may not be enforced as though it were an arbitration award.

3.11 Defects and Defects Liability Period

There are a number of different rules to consider when discussing the contractor’s liability for, by way of example, defects and for damages to the works.

Production Phase

During the production phase, the contractor is liable for any and all damages to the works unless the damage is attributable to the employer.

Liability Period Following Handing Over

The period of liability is ten years from the handover and begins with the guarantee period. According to AB 04, the guarantee period is – if not agreed otherwise – five years for work per-

formed and two years for goods and materials. According to ABT 06, the guarantee period is five years for the total works in their entirety, with the exception of special materials and goods (manufacture) specifically prescribed by the employer (for which the guarantee period is two years). It is common that the employer, wisely, dictates in the tender documents that the guarantee period shall be five years for the works in their entirety – mainly in order to avoid interface issues.

It is also common that the employer dictates that the employer must provide longer guarantee periods for certain materials or goods. The guarantee period for such materials and goods is never shorter than what the contractor may have been guaranteed by its sub-suppliers.

The purpose of the “guarantee period” is that the contractor is liable to remedy any defect that occurs during such period, unless the contractor can demonstrate that it is not responsible for the defect. Hence, the burden of proof lies with the contractor.

Following the end of the guarantee period, the contractor is only liable for substantial defects that appear if the defect is demonstrated to be attributable to negligence on the part of the contractor.

The contractor may not be held liable at all for circumstances or defects notified to the contractor after the end of the ten-year liability period.

Notification of Defects

Any defects must be notified to the contractor without undue delay. Any defects detected during the guarantee period must be notified to the contractor before the end of the guarantee period in order for the employer to invoke such defect as a guarantee defect.

As a general rule, claims for damages must be presented in writing no later than three months after the expiry of certain relevant periods as stipulated in AB 04/ABT 06.

4. Price

4.1 Contract Price

The contract price may be a fixed amount, to be determined in accordance with the prime cost principle (cost plus overheads and profit), or a blend of both.

In the authors' experience, a fixed price is the most common remuneration model. However, certain co-operation models (such as the "partner" model) are normally applied together with a remuneration model, which is based on the prime cost principle but with the addition of an incentive model. Usually, this would entail that the contractor may receive additional remuneration if it is able to complete the project at a lower cost than anticipated, but that the contractor is liable for parts (or whole) of any costs in excess of a budget price agreed between the parties.

In addition, for certain types of projects, remuneration is often determined based on a bill of quantities, whereby the contractor has offered unit prices for the various works included in such bill of quantities and where the unit prices are then multiplied by the actual amounts calculated upon performance of the works.

The parties normally agree on a production-based payment plan, either referring to specific dates or project milestones. In the absence of such payment plan, the contractor is entitled to invoice the employer for work performed, considering the employer's right to withhold 10%

on each invoice until a total of 5% of the agreed contract price has been withheld.

4.2 Indexation

The AB Standards lack indexation clauses, which means that parties who wishes to make the contract price subject to indexation must agree specifically thereto – in connection with which, the parties must agree on a specific index number relevant for their project and the projected cost types.

Please also refer to **5.6 Unforeseen Circumstances**.

4.3 Payment

If a payment is late, a party (normally the contractor) is entitled to interest from the due date as specified in the Interest Act (1975:635), unless another rate of interest has been specified in the construction agreement. Advance payment may be agreed; however, in the authors' experience, it is not commonly seen.

4.4 Invoicing

According to the AB Standards, invoices are due for payment within 30 days of receipt, unless specified otherwise. In the event of a dispute over any portion of an invoice, undisputed amounts must still be paid within the 30-day period. Often, employers stipulate in the tender documents that invoices must be prepared in a certain fashion and include certain information – in the absence of which, the employer is entitled to refuse such invoice.

5. Time

5.1 Planning and Programme

The contractor is required to strategically organise the works to ensure completion within the

designated timeframes, both for the works in their entirety as well as any agreed milestones. A detailed time schedule must be prepared by the contractor and submitted to the employer for review. The employer shall supply any necessary documentation for the contractor's planning that employer may be in possession of. The contractor shall at the employer's request supply information on how the work is progressing in relation to the time schedule.

The timely progress of the works is normally safeguarded by the application of liquidated damages for delay of milestones in order to incentivise the contractor to always follow the time schedule. However, if certain milestones have not been agreed or if liquidated damages for delay in relation to milestones have not been agreed, the employer will in practice have quite limited options to follow up delays or take measures against possible delays – given that, in such a situation it is for the contractor to utilise and plan the agreed contract period as deemed appropriate.

5.2 Delays

Each party must notify the other party without delay of any circumstance that may cause disruption of the time schedule or delay the completion. After such notification, the parties must try to reach an agreement regarding the adjustment of the contract period.

5.3 Remedies in the Event of Delays

For each week or part of a week of delay of the completion of the total works, the contractor must pay liquidated damages as specified in the construction agreement if the delay is attributable to the contractor. This also applies to delays in completing specific parts of the works (ie, milestones), where liquidated damages are payable if so agreed. Claims for liquidated damages must be presented in writing within three months

of the approval of the total works, at the risk of forfeiture of the claim.

Liquidated damages for delay are the normal order and it is also advisable – given that this allows the employer compensation for delay without the need to present further evidence in relation to actual damage, while at the same time presenting the contractor with a clear prerequisite to base its tender on in relation to the timeframes for the project offered by the employer. Liquidated damages are typically agreed as a certain percentage of the contract sum for each commenced week and it is common that liquidated damages are also capped at a certain amount (eg, 10% or 15% of the contract sum). If liquidated damages for delay have been agreed, such liquidated damages constitute the employer's sole remedy for the delay.

However, if liquidated damages are not agreed upon (which, in the authors' experience, is uncommon), the employer is entitled to claim damages for its actual direct losses as a result of the delay.

5.4 Extension of Time

The contractor is entitled to an extension of time in two main situations:

- where variations of the scope or increase in quantities according to the tender documents have occurred and entailed that the total works cannot be completed within the prescribed contract period; and
- where the contractor has been hindered in completing the total works within the prescribed contract period as a result of, for instance, circumstances attributable to the employer, a decision by an authority, war, defence preparations, epidemic, strike, blockade or lockout.

In both cases, the parties must try to agree on a new date for completion, as explained in **5.2 Delays**. However, if the parties cannot agree (which tends to be the normal scenario), the contractor is entitled to an extension of the contract period to the extent necessary, considering the variations or hindrance and its effect on the time schedule. It is for the contractor to demonstrate the actual need of a time extension, as well as the length of the extension to be granted.

When assessing the need for an extension, among other circumstances, the following shall be considered:

- the contractor's ability to minimise delays through efficient resource management, in line with the overarching principle of good faith between the parties; and
- established practices from the sale of goods law concerning a party's control liability may offer interpretive guidance.

Issues of delay, liquidated damages and extension of time are among the more common subject of disputes in the Swedish construction industry.

5.5 Force Majeure

The contractor is entitled to extension of the contract period due to war, defence preparations, epidemic, strike, blockade or lockout, with the exception of strike or blockade resulting from the failure of the contractor or of any of its subcontractors to fulfil their obligations to their employees.

Furthermore, if part of the work not yet handed over is damaged as a result of war, insurrection, natural disaster or comparable circumstances and the damage is substantial or otherwise substantially disrupts the conditions, both the

contractor and the employer are entitled to terminate the agreement.

Although the term “force majeure” is not used in the AB Standards, the above-mentioned rights of the parties are based on the same principles that are generally applicable when determining whether there is a case of force majeure.

5.6 Unforeseen Circumstances

The AB Standards include several provisions designed to handle unforeseen circumstances.

Firstly, there are several provisions relating to unforeseen additional work pertaining to geo-technical conditions, omissions in the employer's documents or other circumstances that the contractor could not have been expected to base calculations on. These types of unforeseen circumstances are handled as so-called equivalent variations, where such additional work as required is deemed to have been prescribed by the employer, who is also obligated to compensate the contractor for such additional work.

Second, there is a specific “hardship” clause included in the AB Standards that allows, primarily, the contractor to demand an adjustment of agreed prices in certain situations – for example, if prices have increased as a result of an epidemic or pandemic or war, or if prices for materials have increased beyond what is to be deemed normal. However, adjustment of prices may be made only if the change in costs has not been foreseeable and if the change in costs substantially affects the whole cost of the total works.

This hardship clause has been heavily debated during recent years, following the extreme increase in costs for many different materials and other supplies, such as fuel and electricity. However, the clause itself is somewhat ambigu-

ous, which has led to a very large number of disputes between employers and contractors regarding whether – and, if so, how – to apply this rule.

Finally, both parties may ultimately terminate the contract without any liability for either party if unforeseen circumstances equivalent to force majeure occur and are not rectified within a certain amount of time.

5.7 Disruption

If variations or changes to a specified quantity in the construction agreement cause a substantial disruption of the conditions for the execution of the contract works, an adjustment to the agreed contract price or other remuneration model shall be made. Notifications and claims for compensation of substantially disrupted conditions must be made without delay and not later than six months after the approval of the total works; otherwise, they will be deemed forfeited.

Whether variations and/or changes to specific quantities are to be deemed a disruption must be evaluated on a case-to-case basis and include an assessment of the nature and scope of the variations or change to quantities, the time consumed when executing them, and the effect that the variation or changes to quantities has had on the contract works in general.

During recent years, there has been a large number of disputes in Sweden where the contractor has invoked its right to a price adjustment on the basis of a substantial disruption. Empirically, the rate of success of these claims is fairly low. The reason for this is presumably the inherent difficulties of demonstrating the actual effect on the contractor's cost calculation for the contract works as a result of a number of variations to the scope, as well as the uncertainty in relation

to how to calculate a possible loss of production. In addition, the relevant provision in the AB Standards offers very little guidance as to the application of it with regard to when a substantial disruption should be deemed to exist, how the price should be adjusted, or the standard of evidence the contractor must consider when submitting its claim.

6. Liability

6.1 Exclusion of Liability

Swedish contract law is based on the principle of freedom of contract, entailing that two commercial parties may agree on whatever exclusions to either party's liability as they please. There is no mandatory law that prohibits the parties from doing so. However, for B2C contracts, there are mandatory laws that prohibit limitations of liability beyond what is stipulated in such laws.

To the extent a limitation of one party's liability may be held to be unreasonably burdensome for the other party, considering all relevant circumstances, the Contracts Act provides rules to ensure that such limitations may be modified or set aside in order to achieve a reasonable result. Of course, when a party has limited its liability fraudulently, or when the other party has agreed to the limitation under duress or similar, such limitation would not be enforceable.

6.2 Wilful Misconduct and Gross Negligence

The concepts of wilful misconduct and gross negligence exist under Swedish law. There are references to these concepts in Swedish legislation, such as the Sale of Goods Act.

The AB Standards deal with the concept of gross negligence to a small and precise extent, mainly

implying that certain limitations of liability do not apply when gross negligence is at hand (see 9.2 Restricting Remedies and 9.3 Sole Remedy Clauses).

6.3 Limitation of Liability

In line with the principle of freedom of contract, parties are free to agree on any limitations of liability. However, limitation of liability clauses can be set aside in the event of wilful misconduct or gross negligence, or if upholding the limitation of liability would be unreasonable.

The AB Standards do not include limitations of liability to a large extent. For damages explicitly referred to in the AB Standards, such as damages to the site or damages resulting from a defect (or damages to third-party property), the responsible party's liability is in principle without limits. However, for certain types of damages, a party's liability is limited to 15% of the contract sum. In addition, neither party is liable for loss due to interruption or disturbance in industrial production or other commercial activities.

As specifically regards consultancy agreements where ABK 09 has been incorporated, the consultant's liability for damages is limited to an amount equivalent to 120 price base units (approximately USD600,000 in 2024), which corresponds to the consultant's obligation to maintain insurance (see 7.3 Insurance).

7. Risk, Insurance and Securities

7.1 Indemnities

The AB Standards do not include any contractual indemnification provisions and it is uncommon for the parties to agree on such provisions – although there are no mandatory provisions

preventing them from doing so (please refer to 6.1 Exclusion of Liability).

7.2 Guarantees

The guarantees typically utilised in Swedish construction contracts are predominantly in the form of bank or insurance guarantees or parent company guarantees.

Guarantees are not governed by statutory law; however, they are commonly employed in construction contracts, as the AB Standards contain a non-compulsory provision to furnish a guarantee. Regarding the contractor, the guarantee should amount to 10% of the contract sum throughout the construction period until approval of the total works – following which, the guarantee shall be reduced to 5% of the contract sum for the first two years of the warranty period. This guarantee is intended to secure the correct completion of the contract works, or agreed remediation of defects, in cases of insolvency or disputes between the employer and the contractor.

7.3 Insurance

Consultant Insurance Obligations

According to the AB Standards, the contractor is obligated to carry insurance that covers damages to the construction site. Additionally, the contractor must have a general liability insurance policy that remains valid throughout the construction period and for at least two years following its completion. In practice, all major insurance companies on the Swedish market offer a specific “construction policy” intended to meet the requirements as stipulated in the AB Standards and – unless additional insurance requirements have been stipulated in an individual agreement – all contractors on the Swedish market will carry sufficient insurance.

Consultants are required to obtain professional indemnity insurance for an amount that corresponds to the agreed-upon liability for damages. This insurance must be kept in force throughout the entire liability period. As with the construction policies, all insurance companies offer consultancy policies that meet the requirements of the AB Standard for consultancy services, ABK 09.

7.4 Insolvency

According to the AB Standards, both parties are entitled to terminate the agreement concerning the remaining parts if the other party becomes bankrupt or otherwise insolvent. In addition, the contractor has the right to terminate or suspend the works if the employer fails to fulfil its obligation to pay for works performed or otherwise fails to discharge their obligations.

7.5 Risk Sharing

Provisions on risk sharing are not commonly included in Swedish standard construction agreements. As a general rule, the parties are responsible for risks within their control. By way of example, in AB 04 contracts, the employer is responsible for the design of the works, whereas the contractor is responsible for performing the works in accordance with the agreement and design.

However, stronger elements of risk sharing can be observed in partnering construction contracts, where the employer and the contractor typically co-operate to a greater extent, often working in joint teams. One way the parties usually share risk for cost increases in partnering projects is by agreeing on remuneration based on an incentive model where the contractor would be allowed to share savings in relation to an agreed “budget price” – whereas, in the event of cost increases beyond the budget price, the contractor would have to carry a part of such

cost increase itself. However, given that there is no standard agreement specifically tailored to partnering agreements, the extent of shared risks can vary significantly depending on the terms agreed upon in the particular contract. As a ground rule, the parties would be wise to be extra careful when allocating the risk between them in partnering contracts, as this may otherwise lead to the risk of disagreements.

8. Contract Administration and Claims

8.1 Personnel

In the AB Standards, the parties are responsible for any damages caused by their personnel.

If the execution of the total works should be jeopardised because the contractor fails to fulfil its obligation to its employees, the employer of the construction is entitled to discharge the obligations on behalf of the contractor and at the contractor's expense and risk.

8.2 Subcontracting

Unless explicitly agreed otherwise, the contractor is entitled to engage subcontractors to perform parts of the work, or even all the total works. Both parties are liable for any actions or omissions of their respective subcontractors. The same principles apply to subconsultants under ABK 09. Please see 2.3 The Subcontractors.

8.3 Intellectual Property Intellectual Property in AB Standards

The AB Standards do not encompass extensive regulations concerning IP rights. However, they do contain provisions aimed at protecting a tenderer during the tender phase. These provisions primarily ensure that information submitted in a

tender cannot be utilised by the recipient without the consent of the submitting party.

Intellectual Property in Standard Consultancy Agreements

In contrast, the regulation of IP rights assumes a more central role in standard consultancy agreements. This focus is understandable given the nature of the consultancy work, which typically revolves around the consultant's responsibility to deliver construction design.

Central provisions normally include that the client is only entitled to use the result of the assignment for the intended purpose. Thereto, the client shall safeguard the results of the assignment from unauthorised copying and distribution and may not transfer any rights to a third party unless the consultant has received payment in conformity with the contract or acceptable security has been provided. As regards inventions resulting from the assignment, the client is entitled to full or partial participation as a rights-holder with regard to the invention, in some cases against reasonable compensation.

9. Remedies and Damages

9.1 Remedies

General

As a general rule, a party invoking legal remedies has a duty to notify the other party without delay or, in certain cases, within fixed deadlines. The duty to notify applies as a general principle of contract under Swedish contract law, and the AB Standards include specific fixed deadlines depending on the situation at hand. During recent years, the Supreme Court has in several cases ruled that the consequence of a party's omission to notify without undue delay is gener-

ally forfeiture of the claim for which notices have not been given on time.

The remedy available in the event of breach of contract depends on what the breach relates to and the severity of the breach. Typical breaches of contract relate to delay and defects, for which the AB Standards provide remedies. Further, the AB Standards provide that a party is entitled to hold the other party liable for damages suffered due to the other party's breach of contract, or as a result of a defect for which the contractor is liable.

Employer

In the event of delay, the most common remedy available to the employer is liquidated damages (see 5.3 Remedies in the Event of Delays).

Concerning defects, the contractor has both a duty and a right to rectify defects noted in the protocol from the final inspection or as otherwise notified by the employer. Should the contractor fail to rectify the defects within the prescribed time or declare that it does not intend to rectify the defect, the employer may have the defect rectified. If the contractor is responsible for the defect, the contractor is liable for the cost of rectification.

Contractor

If the contractor is entitled to terminate the contract – for instance, owing to the employer's failure to provide payment in due time – the contractor may instead choose to suspend the works in order to apply pressure on the employer. However, such suspension may however not be longer than one month – after which, the contractor must either recommence its works or terminate the contract.

9.2 Restricting Remedies

It is not uncommon that parties contractually limit the remedies available in the event of breach of contract, typically in the form of a restriction on the maximum amount of liquidated damages or other damages payable in the event of breach of contract.

Generally, Swedish courts or tribunals will uphold limitation of liability clauses. However, according to general principles of law, such limitations may be set aside in cases of wilful misconduct or gross negligence or by application of Section 36 of the Swedish Contracts Act regarding setting aside unreasonable contract provisions (please also refer to **6.2 Wilful Misconduct and Gross Negligence**).

9.3 Sole Remedy Clauses

Sole remedy clauses are generally not used in Swedish construction contracts. However, if the parties have agreed upon liquidated damages for delay, the employer is not entitled to claim additional damages due to the delay, unless explicitly agreed otherwise. In such case, liquidated damages are the exclusive remedy for the delay.

According to the principle of freedom of contract, Swedish courts and tribunals will generally uphold sole remedy clauses. However, such clauses could be set aside in cases of wilful misconduct or gross negligence or by application of Section 36 of the Swedish Contracts Act regarding setting aside unreasonable contract provisions.

9.4 Excluded Damages

In general, the AB Standards do not exclude certain damages from liability. However, as specifically regards loss due to interruption or disturbance in industrial production or other

commercial activities, the AB Standards include a general exclusion of liability for such loss. In principle, this is very similar to a general exclusion of liability for indirect or consequential loss.

9.5 Retention and Suspension Rights

Retention

During the contract works, the employer is entitled to retain 10% on each invoice for works performed (albeit not more than 5% of the contract sum) as security for the rectification of defects. After the approval of the works, the employer is entitled to retain 5% of the contract sum for up to two months following approval of the total works as security for rectification of defects as noted in the minutes from the final inspection. In addition, the employer is entitled to retain a reasonable amount relating to other claims pertaining to, for example, defects, liquidated damages and other damages.

Suspension

As explained in **9.2 Restricting Remedies**, the AB Standards entail that the contractor is entitled to suspend the works if the contractor is entitled to terminate the contract.

The employer has a general right to suspend the works, or even discontinue the project in total (see **9.6 Termination** for more detail), at the employer's discretion. Should the employer suspend the project for a certain period, the contractor is entitled to extension of time as needed once the employer instructs to recommence the project, as well as compensation for all costs incurred as a result of the suspension.

9.6 Termination

Both parties are entitled to terminate the contract if specific circumstances apply. Primarily, such circumstances relate to the other party's failure to provide adequate security, changes in

the financial status of the other party, or where the works are severely disrupted. In addition, the employer is entitled to terminate the contract in the event of severe delay, whereas the contractor has an equivalent right if the employer fails to make payment in due time.

As regards construction contracts publicly procured, it is mandatory to incorporate supplementary termination clauses for the employer, specifically pertaining to adherence to employment and social responsibility standards, compliance with public procurement laws, and the prohibition of unauthorised alterations to the contract.

Both parties are entitled to claim damages for any loss suffered as a result of the termination.

In addition to the right to terminate, the employer has an unconditional right to discontinue the entire project for convenience. If this situation occurs, the AB Standards include provisions to compensate the contractor for its loss of revenue and profit for the part of the works discontinued.

10. Dispute Resolution

10.1 Regular Dispute Resolution

According to the AB Standards, disputes shall be settled in the general courts unless the amount in dispute obviously exceeds 150 price base amounts (which, for 2024, corresponds to

approximately SEK8.5 million) – in which case, the dispute must be settled by arbitration in accordance with the Swedish Arbitration Act. Parties would normally be wise to amend this provision by agreeing that disputes that must be settled by arbitration shall be settled by arbitration according to an appropriate arbitration institute, which on the Swedish market is the SCC Institute (formally the Arbitration Institute of the Stockholm Chamber of Commerce).

10.2 Alternative Dispute Resolution

In addition to the dispute resolution clause, the AB Standards also include the option to use a simplified disputes resolution procedure, which entails that the parties – by agreement following the occurrence of a dispute – may submit their dispute to a competent and unchallengeable sole “arbitrator” (although this should not be confused with actual arbitration). Such simplified dispute resolution adjudication is subject to agreement between the parties once the dispute has occurred; however, if utilised, it provides a swift and cheap way of resolving smaller and non-complex disputes.

Mediation is quite commonly utilised and often such mediation is conducted according to the SCC Institute’s Rules for Mediation – normally as a part of a combination arbitration clause where mediation is provided as the first choice for dispute resolution, followed by arbitration if mediation is unsuccessful.

SWITZERLAND



Law and Practice

Contributed by:

Christian Eichenberger, André Kuhn and Nadja D. Leuthardt
Walder Wyss Ltd

Contents

1. General p.608

- 1.1 Governing Law p.608
- 1.2 Standard Contracts p.608

2. Parties p.608

- 2.1 The Employer p.608
- 2.2 The Contractor p.609
- 2.3 The Subcontractors p.609
- 2.4 The Financiers p.610
- 2.5 The Designer p.610

3. Works p.610

- 3.1 Scope p.610
- 3.2 Variations p.610
- 3.3 Design p.610
- 3.4 Construction p.610
- 3.5 Site p.611
- 3.6 Permits p.611
- 3.7 Maintenance p.611
- 3.8 Other Functions p.611
- 3.9 Tests p.612
- 3.10 Completion, Takeover and Delivery p.612
- 3.11 Defects and Defects Liability Period p.612

4. Price p.613

- 4.1 Contract Price p.613
- 4.2 Indexation p.613
- 4.3 Payment p.613
- 4.4 Invoicing p.614

5. Time p.614

- 5.1 Planning and Programme p.614
- 5.2 Delays p.614
- 5.3 Remedies in the Event of Delays p.614
- 5.4 Extension of Time p.614
- 5.5 Force Majeure p.615
- 5.6 Unforeseen Circumstances p.615
- 5.7 Disruption p.616

6. Liability p.616

- 6.1 Exclusion of Liability p.616
- 6.2 Wilful Misconduct and Gross Negligence p.616
- 6.3 Limitation of Liability p.616

7. Risk, Insurance and Securities p.616

- 7.1 Indemnities p.616
- 7.2 Guarantees p.616
- 7.3 Insurance p.617
- 7.4 Insolvency p.617
- 7.5 Risk Sharing p.617

8. Contract Administration and Claims p.617

- 8.1 Personnel p.617
- 8.2 Subcontracting p.618
- 8.3 Intellectual Property p.618

9. Remedies and Damages p.618

- 9.1 Remedies p.618
- 9.2 Restricting Remedies p.619
- 9.3 Sole Remedy Clauses p.619
- 9.4 Excluded Damages p.619
- 9.5 Retention and Suspension Rights p.619
- 9.6 Termination p.619

10. Dispute Resolution p.619

- 10.1 Regular Dispute Resolution p.619
- 10.2 Alternative Dispute Resolution p.620

Walder Wyss Ltd has around 280 legal experts and is one of the most successful and fastest-growing Swiss commercial law firms, with offices in Zurich, Geneva, Basel, Berne, Lausanne and Lugano. Walder Wyss has one of Switzer-

land's biggest teams of real estate and construction lawyers. Clients include national and international companies, publicly held corporations and family businesses, as well as public law institutions and private clients.

Authors



Christian Eichenberger is a partner in the real estate team of Walder Wyss and focuses on real estate development, real estate transactions and real estate dispute resolution. He

studied law at the University of Freiburg and the University of Hawaii, and has a Doctorate from the University of Berne. He clerked at the Zug Administrative Court and worked as an attorney at law and civil law notary public with two law firms in Zug and Zurich. Christian regularly publishes and lectures in his fields of expertise. He is admitted as a Professional Member of the Royal Institution of Chartered Surveyors (MRICS), as well as a Certified Specialist: Construction and Real Estate Law of the Swiss Bar Association.



Nadja D. Leuthardt is a senior associate in the real estate team of Walder Wyss. She advises institutional and private clients in the areas of public and private construction law, tenancy law

and in other aspects of property law (including condominium ownership). She holds a BLaw and an MLaw from the University of Basel. After being admitted to the bar in 2018, she also completed the CAS Real Estate Investment Management as well as the CAS Real Estate Asset Management at the Lucerne University of Applied Sciences and Arts and has recently finished her dissertation in the field of condominium law at the University of Fribourg (publication pending).



André Kuhn is a partner at Walder Wyss and advises clients on all aspects of real estate law, particularly real estate transactions, real estate investment structures, tenancy

law and private building law. He holds Bachelor's, Master's and Doctoral degrees in Law from the University of Bern (BLaw, MLaw and Dr iur) and regularly publishes in his areas of expertise. André is also admitted as a notary in the Canton of Bern.

Walder Wyss Ltd

Seefeldstrasse 123
8008 Zurich
Switzerland

Tel: +41 58 658 58 58
Fax: +41 58 658 59 59
Email: reception@walderwyss.com
Web: www.walderwyss.com

walderwyss

1. General

1.1 Governing Law

The construction market in Switzerland is mainly governed by the Swiss Code of Obligations (see Articles 363 et seq and 394 et seq of the Swiss Code of Obligations and www.fedlex.admin.ch). If the employer is a public corporation, public procurement law may also be applicable.

In addition, there are various legal and technical standards, guidelines and recommendations issued by professional associations (namely the [Swiss Society of Engineers and Architects](http://www.sia.ch/en/the-sia/), SIA, www.sia.ch/en/the-sia/), which are regularly agreed as binding in contracts for construction services (eg, general terms and conditions according to SIA 118:2013).

1.2 Standard Contracts

The use of certain standard contracts is not mandatory in Switzerland. However, the parties to a construction contract frequently use the general terms and conditions issued by the Swiss Society of Engineers and Architects (SIA). Public entities typically use the standard forms established by the Co-ordination Conference of the Construction and Real Estate Agencies of the Public Principals (*Koordinationskonferenz*

der Bau- und Liegenschaftsorgane der öffentlichen Bauherren – KBOB).

2. Parties

2.1 The Employer Types of Employers

The Swiss construction industry features the following different types of employers:

- institutional investors such as real estate funds;
- private owners; and
- contractors assigned to construction projects by the government.

For the execution of the construction work, the employer enters into a contract with a single contractor (general contractor model or total contractor model, see **2.2 The Contractor**) who, in turn, may use subcontractors. Alternatively, the employer can conclude individual contracts with different contractors (so-called single contractor model, see **2.2 The Contractor**).

Rights and Obligations

The rights and obligations of the employer are determined by the specific contract, by the Swiss Code of Obligations (usually within the section

about contracts for work and services – Article 363 et seq) and frequently by contractual regulations of the Swiss Society of Engineers and Architects, SIA (especially SIA 118:2013). The employer's primary duty is the payment of the price within the specified timescale. The agreement may also cover other duties, such as the duty of loyalty and compliance with intellectual property rights of the contractor or a third party.

2.2 The Contractor

Types of Contractors and Contractor Models

All kinds of companies act as constructors, with larger listed companies typically acting as contractors in the Swiss construction industry.

There are various contractor models that can be chosen to realise a construction project. Besides a single contractor model, general or total contractor models are often used. In summary, the following can be said about the individual models:

- Single contractor model - In the single contractor model (*Einzelunternehmer-Modell*), the employer concludes various contracts with individual contractors, whose work must be co-ordinated by the employer or by an appointed construction manager (eg, project/development manager, generally an architect, see 3.8 Other Functions).
- General contractor model - In the general contractor model (*Generalunternehmer-Modell*), separate contracts are concluded for construction planning and construction execution. For the planning of the construction work the employer commissions an architect and an engineering team. The employer either enters into a single planning contract with a consortium of planners/designers (often in the form of a simple partnership) or concludes

individual contracts with each architect or engineer involved.

For the execution of the construction work, the owner enters into a contract with a contractor who, in turn, uses subcontractors.

- Total contractor model – In the total contractor model (*Totalunternehmer-Modell*), the employer contracts with one contractor that assumes full responsibility for the planning and realisation of the construction project.

Rights and Obligations

The rights and obligations of the contractor are again determined by the specific contract and the chosen contractor models (see 2.2 The Contractor), by the Swiss Code of Obligations and frequently by contractual regulations of the Swiss Society of Engineers and Architects, SIA (especially SIA 118:2013). The contractor's primary duty is to carry out work in person within the agreed time schedule, unless the nature of the work does not require its personal involvement. The agreement may also cover other duties, such as the duty of loyalty and intellectual property rights, supervision and insurance duties.

2.3 The Subcontractors

In Switzerland, subcontractors are typically rather small companies that specialise in a particular field. Subcontractors are usually appointed by a general/total contractor, which means that there is generally no contractual relationship between the subcontractor and the employer. The subcontractor-contract is typically a contract for work and services in which the contractor assumes the role of the employer and the subcontractor takes the place of the contractor, meaning the same rights and obligations as listed in 2.2 The Contractor apply.

2.4 The Financiers

Typically, construction projects are financed by banks, insurance companies or real estate funds. For this purpose, the employer takes out a mortgage loan with the respective funding party and undertakes to repay it in instalments by means of mortgage interest. If the employer defaults on the payment, the financier has the right to pledge the property.

2.5 The Designer

Types of Designers

Designers can either be organised in the form of a legal entity, as partnerships or as sole traders (*Einzelunternehmung*). For large construction projects, designers are usually organised in the form of a legal entity.

Rights and Obligations

The rights and obligations of the designer depend on the contractual arrangement between the designer and the employer. These are typically based on the terms and conditions of the SIA (namely SIA 102). A designer is usually an architect who prepares or modifies designs for construction projects or who arranges for or instructs other companies to do so. The designer is usually appointed by the employer. It is, however, also possible that a contractor (in particular a total contractor, see **2.2 The Contractor**) appoints the designer. In the event that the designer is not only commissioned with the design, but also acts as a contractor for the employer, reference can be made to the information above (see **2.2 The Contractor**).

3. Works

3.1 Scope

In Switzerland, the scope of construction services in construction contracts is typically deter-

mined on the basis of a detailed list of construction services, which is usually based on the element-oriented cost classification for building construction (*Baukostenplan* – BKP), on functional definitions of construction services or on combinations of the two.

3.2 Variations

Contracts usually contain specific provisions for change orders. SIA Rule 118:2013 typically applies to construction contracts and contains specific provisions in this regard (Article 84 et seq). As a general principle, the scope of services and the associated changes in costs compared to the initial cost base, in some cases also delays in deadlines, are the determining factor.

Where labour rates or prices undergo an increase or decrease compared to the initial cost base, the consideration owed by the employer shall similarly be subject to an increase or a decrease. However, this does not apply for fixed flat-rate prices (see **4.1 Contract Price**) or “time and materials works” that are subject to an agreed quotation where no reservation for price adjustments was stipulated.

3.3 Design

As a kind of standard model in construction projects, architects are responsible for all design works and construction management. However, there are also various other contractor models, as described in **2.2 The Contractor**.

3.4 Construction

The responsibilities regarding the construction process depend on the contractor model used in the construction process (see **2.2 The Contractor**).

The general contractor and total contractor are solely responsible for all works, as there is no

contractual relationship between the employer on the one hand and the subcontractors and suppliers on the other.

If the work is individually allocated (single contractor model), the employer enters into direct contracts with the contractors. The contractors are responsible for the construction process, and the employer has to supervise the project. An exception applies in cases where the employer has appointed a construction manager (see **3.8 Other Functions**). In this case, the construction manager is responsible for the management of all works and each contractor for its division of work (resulting in the joint liability of the architect and the contractor for certain defects, as the case may be).

3.5 Site Responsibility for the Status of the Construction Site

The responsibility for the status of the construction site (eg, regarding pollution, underground obstacles, geotechnical conditions, archaeological finds) again depends on the specific contractor model (see **2.2 The Contractor**).

The general contractor and the total contractor are solely responsible for the status of the construction site. The construction manager is responsible for the management of all risks. All contractors must notify the employer and the construction manager (if any) if they become aware of any such risks.

Risk Allocation

According to the “polluter pays” principle (*Verursacherprinzip*), the site owner is responsible for the management of such risks by law. However, risk allocation can be subject to the agreement of the parties. Typically, the risk management is transferred to the planners and contractors.

Statutory law provides for additional specific obligations for contractors (eg, correct handling of decontamination works).

3.6 Permits

With only a few exceptions, all construction works are subject to building permits. If additional permits are required (eg, based on the Water Protection Act, the Environmental Protection Act, fire police requirements or cantonal law), the authority must co-ordinate all permit procedures and include all additional permits in the building permit. For large-scale projects, an environmental impact assessment might be required.

The employer is legally obliged to ensure that all necessary building permits for the construction measures are issued. However, typically, the construction manager (usually an architect) and/or the contractor is contractually responsible for obtaining the necessary permits, but this depends on the individual agreement.

3.7 Maintenance

There are basically no specific maintenance provisions under Swiss law. The employer is free to mandate any contractor of its choice for maintenance works. However, certain contractors typically agree to extend guarantee periods (eg, for the roof or facade), provided that the employer enters into a maintenance agreement, which comes into force immediately after completion of the construction work.

3.8 Other Functions

Employers typically mandate construction managers for large-scale projects, who manage the entire project and take over the administration of tasks.

Furthermore, as subcontractors have the mandatory right to register a contractor's lien on the property if they are not paid by the contractor, it is recommended that the payment of the subcontractors is monitored (eg, by a bank).

3.9 Tests

In Switzerland, there are no general testing obligations for construction processes. Typically, testing is part of the acceptance procedure and must be prepared, organised and performed by the construction manager and/or the contractor.

However, certain acceptance procedures (eg, fire protection, elevators) may be subject to prior testing by the authorities. Furthermore, an official inspection of the project is undertaken by the competent authority of the local community before the building can be inhabited or used for its intended purpose.

3.10 Completion, Takeover and Delivery

Typically, the acceptance procedure proceeds as regulated in Article 157 et seq of the SIA 118:2013, whereby the general contractor, the total contractor, the construction manager or another contractor invites the employer to a joint acceptance. In the case of major defects, the acceptance fails. Minor defects must be reported and repaired within a reasonable period of time.

Takeover can also take place before acceptance. However, this involves risks regarding defects, as it may be construed as a waiver in relation to defects and may, from a technical point of view, complicate the allocation of responsibility for defects.

3.11 Defects and Defects Liability Period Defects Liability Period According to the Swiss Code of Obligations

According to the Swiss Code of Obligations (Article 367 et seq), the employer must inspect the quality of the work after delivery and inform the contractor of any defects. If the employer fails to carry out the inspection, it implicitly approves recognisable defects. The inspection period is not defined by law; according to the Federal Supreme Court, it is a few days or, in the case of complex works, several months. The defects must then be reported to the contractor "immediately" after their discovery (within approximately seven days). The parties may, however, provide for other notice requirements in their contracts. It is advisable and often the case in practice to either contractually agree on a longer inspection and notice period or to jointly perform the inspection. In this respect, a planned revision of the Swiss Code of Obligations provides that a new deadline of 60 days or even longer shall apply to the notification of defects in immovable works. The revision is currently being debated in the Swiss parliament.

Defects Liability Period According to the SIA 118:2013 Rule

The SIA 118:2013 rule is based on the principle of joint inspection, whereby the work is to be inspected within one month upon notification by the contractor (Article 158 of the SIA 118:2013). Thereafter, the employer must notify the contractor of defects within two years from the date of acceptance of the work. Obvious defects must be notified at the time of acceptance. Defects that are discovered after the notification period of two years (hidden defects) must be notified immediately after their discovery, which is possible until the expiry of the limitation period.

However, parties are free to agree on different provisions.

Limitation Period

Defect rights prescribe even if the defects have been notified in good time. For construction works, the limitation period is generally five years from acceptance of the work (Article 371 Paragraph 1 and 2 of the Swiss Code of Obligations; Article 180 Paragraph 1 of the SIA 118:2013), subject to interruption of the limitation period (eg, by filing a claim).

4. Price

4.1 Contract Price

In return for the services performed by the contractor, prices are usually agreed on a time-spent basis or as unit prices (*Einheitspreise*) or fixed prices, such as a lump sum price (*Globalpreis*) or at a flat rate price (*Pauschalpreis*).

Unit Prices

Unit prices determine the consideration for individual services that are listed as separate items in the schedule of services. They are defined for the individual units of quantity, so that the consideration owed for a service is computed after its completion. The quantities of services performed at unit prices are determined according to the terms of the contractor agreement, in accordance with their actual measure (by measurement, weighing or counting) or with their theoretical measure based on the underlying designs.

Lump Sum Price

A lump sum price may be agreed for individual services, for part of the project or for the entire project carried out by the contractor. It shall consist of a fixed amount of money. Agreements on

lump sum prices should only be made on the basis of complete and clear documentation (ie, detailed project specifications and designs).

Flat Rate Price

Flat rate prices differ from lump sum prices solely in that they are not subject to price adjustment clauses.

Milestone Payments

Milestone payments are typically agreed on by the parties, with payments on account.

4.2 Indexation

Indexation of the contract price has become more and more common, in particular for larger construction projects with a long-term execution period (especially if a lump sum price or a flat rate price is agreed, see 4.1 Contract Price). In this case, index clauses as price adjustment mechanisms are contractually provided for. Based on such an index clause, the originally agreed price can be subsequently adjusted due to inflation-related price changes. The index to which the price is linked must be contractually defined between the parties. In Switzerland, it is customary to link the work price increase to the construction cost index (*Baukostenindex*). SIA has also specified certain rules with price adjustment mechanisms that can be contractually agreed (namely Article 64 et seq of the SIA 118:2013 as well as the regulations according to SIA 122, SIA 123, SIA 124, SIA 125 and SIA 126). If no indexation has been agreed between the parties, cost increases may, in extreme cases, justify price adjustments as extraordinary circumstances.

4.3 Payment

There are various concepts to prevent late or non-payment in construction contracts. Typically, the parties agree on a payment schedule

consisting of milestone payments, to be paid on account. There can also be advance payments, which are typically secured by a bank guarantee.

However, if the employer does not pay on time, the contractor has the right to stop the work and register a so-called contractor's lien.

4.4 Invoicing

Typical billing methods used in construction contracts in Switzerland are payments on account (milestones) and a final payment. Invoices are then sent to, and reviewed by, a cost controller.

5. Time

5.1 Planning and Programme

There are typically different planning phases in construction projects:

- strategic planning;
- preliminary studies;
- planning of the project;
- invitation to tender;
- implementation; and
- management.

In most cases, there is a construction schedule that sets specific dates indicating milestones that must be reached by certain dates. In this context, there is often a payment schedule based on the degree of completion. Contractual penalties are usually agreed to enforce compliance with the deadlines.

5.2 Delays

The construction schedule is often declared as binding.

In most construction cases, the contractor has the right to an extension of the contractual per-

formance period for a reasonable period if the execution of the project is delayed with no fault on the part of the contractor (Article 96 of the SIA 118:2013). The employer and the contractor are liable to each other for damage resulting from exceeding performance.

For cases in which contractual performance periods are exceeded, the contractor agreement typically provides for reasonable penalties which are, however, in general not owed where the contractor is entitled to an extension of performance periods (see Articles 98 and 96 of the SIA 118:2013). Also, the contractor agreement typically provides that a contractually stipulated penalty shall not constitute a release from remaining contractual obligations but shall be accounted towards the payment of any damages owed.

In the event of delays caused by the contractor, where there is no longer any prospect of completing the work on time, the employer has the right to withdraw from the contract without waiting for the agreed delivery date (Article 366 of the Swiss Code of Obligations).

5.3 Remedies in the Event of Delays

Typically, default interest or contractual penalties are agreed in the event of delays. Furthermore, the parties are liable for damage resulting from exceeding performance.

5.4 Extension of Time

If it is likely that the execution of the project will be delayed through no fault on the part of the contractor, that contractor must make additional arrangements with the employer in order to prevent further delays, such as increasing the size of the workforce or putting on additional work shifts. If the execution of the project is still

delayed, the contractual performance periods must be extended for a reasonable period.

Changes to construction procedures, faulty supplies or other causes of delay attributable to fault on the part of the contractor will, however, not give rise to an entitlement to the extension of any performance periods. If the contractor is not entitled to an extension of performance periods, the employer has the right of withdrawal.

5.5 Force Majeure

Article 376 of the Swiss Code of Obligations provides that if the work is destroyed prior to delivery by a force majeure event the contractor cannot, in principle, demand compensation for its labour nor restitution of its expenditures.

Apart from the aforementioned regulation, the Swiss Code of Obligations does not expressly regulate force majeure, but this principle is nevertheless recognised in case law and is subsumed under Article 119 of the Swiss Code of Obligations. If performance has become impossible due to circumstances for which the debtor is not responsible, the claim is considered extinguished under Swiss law in accordance with Article 119 of the Swiss Code of Obligations. The debtor must no longer perform.

As part of the contractual freedom prevailing in Swiss private law, the parties involved may contractually extend or restrict the statutory scope of the application of force majeure. Such clauses chosen by the contracting parties generally override the subsidiary provisions in Article 376 and Article 119 of the Swiss Code of Obligations. Many contracts and general terms and conditions contain a force majeure clause, according to which, for example, pandemics, official restrictions or other unexpected occurrences are to be qualified (or not) as force majeure.

Contractual force majeure clauses usually also contain provisions on the legal consequences (termination, liability for damages or grace periods) of late performance or non-performance due to the event that has occurred, if there is a causal connection. One of the most commonly used force majeure clauses is stated within Article 187 paragraph 3 of the SIA 118:2013, according to which the contractor is entitled to full or partial equitable consideration for services performed prior to any loss or destruction of a project resulting from force majeure (eg, war, civil unrest, natural disaster). Where a dispute arises, the court decides at its discretion.

5.6 Unforeseen Circumstances

The unexpected extent of the COVID-19 pandemic raised not only the question of force majeure but also the principle of *clausula rebus sic stantibus*. The retrospective amendment of contracts caused by unforeseen circumstances is not regulated in mandatory or regulatory law. However, the Swiss doctrine acknowledges this so-called *clausula rebus sic stantibus*, which allows the court to change contracts if (i) due to a change of circumstances, or (ii) the performance of the contract becomes unconscionable for at least one party. Often, the legal consequences of the occurrence of unforeseen circumstances are also contractually agreed upon by the parties. In particular, the issues of pandemics and inflation have often been explicitly addressed in contracts since the COVID-19 pandemic and the Russia-Ukraine war, respectively.

Changes in Orders

After the contract has been concluded, both the employer and the contractor may want to modify the agreed services. Such changes in orders can be contractually agreed between the parties. Also, the employer is generally entitled to demand changes to the order before completion

of the work, whereby the employer must indemnify the constructor in full (Article 85 et seq. of the SIA 118:2013).

5.7 Disruption

Disruption in the sense of a loss of productivity due to a hinderance or interruption in the progress of the construction works which reduces the rate of efficiency is generally not acknowledged as a specific legal and/or contractual reason for an extension of time and/or compensation. Such disruptions are normally treated the same way as delays (see Article 97 of the SIA 118:2013 and 5.2 Delays).

6. Liability

6.1 Exclusion of Liability

According to the mandatory law provisions in Switzerland, agreements purporting to exclude liability for wilful misconduct or gross negligence in advance are void. Also, an advance exclusion of liability for minor negligence may be deemed void if the party excluding liability was in the other party's service at the time the waiver was entered into or if the liability arises in connection with commercial activities conducted under an official licence.

6.2 Wilful Misconduct and Gross Negligence

As stated in 6.1 Exclusion of Liability, the exclusion of liability for wilful misconduct or gross negligence in advance is void. These concepts are governed by mandatory law (Article 100 of the Swiss Code of Obligations).

6.3 Limitation of Liability

Within the framework of Article 100 of the Swiss Code of Obligations (see 6.2 Wilful Misconduct and Gross Negligence), the limitation of liability

is possible. Consequently, liability for slight negligence can be excluded in a contract. The entire system of guarantees is dispositive; there is a broad scope for drafting contractual limitation of liability. However, in order to make the contract more attractive, liability is often not completely excluded, but rather limited to a certain amount, such as the total amount of the agreed costs or the service provider's sum insured.

7. Risk, Insurance and Securities

7.1 Indemnities

Indemnities are generally used to limit risks in Swiss construction projects. Typical subjects would be damage/loss of profit due to delays and third-party claims (eg, damage to the neighbouring property due to the construction works).

Liability of contractors is often limited (eg, to the amount of the sum insured).

7.2 Guarantees

Employers are typically granted the following in the form of an abstract, irrevocable guarantee within the meaning of Article 111 of the Swiss Code of Obligations from a major Swiss bank or cantonal bank or insurance company:

- a performance guarantee securing all obligations of the contractor under the contract (reimbursement of excess payments, costs for substitute performance by the customer, reductions in price, consequential damages resulting from defects, contract penalties, release or securing any contractors' liens, consequences of early termination of a contract, etc);
- a warranty guarantee securing the contractor's liability for defects; and

- as the case may be, a prepayment guarantee securing the prepayments of the employer.

The warranty guarantee is often provided in the form of a surety (*Solidarbürgschaft*) from a major Swiss bank, a cantonal bank or an insurance company.

7.3 Insurance

In most cantons, there are mandatory insurance requirements relating to a building (eg, mandatory progressive building insurance).

Typically, the architect or the total/general contractor must ensure that the employer has sufficient insurance coverage. This includes insurance coverage for third-party damages and for defects of existing buildings and installations (*Bauwesenversicherung*).

All contractors must provide (and maintain) professional indemnity liability insurance.

Large-scale projects often provide construction area insurance (*Bauplatzversicherung*) that covers all planners and contractors of the project and an additional insurance policy covering interruption in construction resulting from fire.

7.4 Insolvency

In the event of the formal bankruptcy of a contractor, the employer has the right to terminate the contract early by law. However, under the contract, the employer is granted the right to terminate the contract early in the event of certain financial difficulties on the part of the contractor (eg, a petition for a debt restructuring moratorium, liquidation of parts of the company) even before the opening of bankruptcy proceedings.

In addition, contracts often include a right for the employer to make direct payments to subcon-

tractors that will be deducted from the contract price if the contractor does not pay its subcontractors on time.

Regarding financial difficulties of the employer, contractors have the right to suspend their works if they are not paid on time. Moreover, contractors have the mandatory right to register a contractor's lien in order to secure the payment of works already performed.

7.5 Risk Sharing

Given the freedom of contract principle in Switzerland, it is admissible for the parties to agree to share any type of risk between them.

However, risks are not usually shared by the parties: certain kinds of risks are typically borne by the employer (eg, risk of unforeseen ground conditions) while others are usually covered by the contractor (eg, cost risk).

8. Contract Administration and Claims

8.1 Personnel

There are various mandatory provisions for a contractor's personnel (work security, laws on dispatching employees, etc). While the employer may not be held responsible if the contractor does not observe such requirements, doing so might have a negative impact, from both an economic (eg, the stopping of construction by the authorities) and a reputational perspective, so that this issue is often specifically addressed in the contract and secured by penalties and the right to terminate the contract early.

In addition, contracts often include provisions regarding key persons and their replacement, as well as the right of the employer to request

that the contractor no longer engages a specific person for rendering the works.

8.2 Subcontracting

In Switzerland, the contractor is usually free to enter into subcontractor agreements. However, contractors are responsible for ensuring that their subcontractors observe the statutory laws on work security and on dispatching employees. In international relations, the contractor and, under certain conditions, the employer are particularly liable for the subcontractors' compliance with the minimum wages and working conditions applicable under Swiss law (Article 5 of the Posted Workers Act).

For the employer, the appointment of subcontractors by the contractor also represents a certain risk with regard to building contractor's liens (see **9.1 Remedies**).

Employers may therefore reserve various rights when it comes to the appointment of subcontractors (such as the right to approve subcontractors, to require the engagement of certain subcontractors, a direct payment right in the event that the contractor fails to pay its subcontractors in breach of contract etc).

8.3 Intellectual Property

Pursuant to SIA Rule 102:2020 and 103:2020, respectively, the architect and the engineer shall retain the copyright on their work and the employer, upon payment of the fees, shall be entitled to utilise the architect's and engineer's work results for the agreed purpose (Articles 1.3.1 and 1.5.3 of the SIA Rule 102:2020 and Articles 1.3.1 and 1.5.3 of the SIA Rule 103:2020).

However, typically, contracts relating to large-scale projects include the full assignment and

transfer of all work results and other intellectual property rights to the employer.

9. Remedies and Damages

9.1 Remedies

In the event of a breach of the construction contract, Swiss law provides several remedies for the different parties.

From the view of the employer, the most important remedies are rescission, reduction or rectification (Article 368 of the Swiss Code of Obligations). In principle, the employer is free to choose which claim it wishes to pursue (the so-called right of choice), whereby the claims for defects for buildings are usually limited to reduction or rectification. The choice of the right of rectification presupposes that the defect in the work is of minor importance, that the rectification of the construction defects is possible and that no excessive rectification costs are incurred by the contractor.

In addition to the rights in terms of defects, the employer may also claim compensation for any consequential damage caused by a defect, to the extent the contractor is at fault.

From the view of the contractor, the most important remedy is the so-called building contractor's lien. If the employer has failed to meet his payment obligation, the contractor has the option to register a lien on the employer's property in the amount of his claim. This must be done within four months of the completion of the construction work. If the employer still fails to pay, the contractor is entitled to seize the property and thus obtain his remuneration for the work. However, only "building contractors" are entitled to this right; architects cannot pursue this claim but

have the option of asserting copyrights to their work in court. The employer may then only continue to use the work or plan if the claim is paid.

The subcontractor has no contractual relationship with the employer. A unique feature of Swiss law is that, in the event of non-payment, the subcontractor still has the option to have a construction lien registered on the employer's property to secure its claim, even though the employer may not be at fault for the non-payment of the claim.

9.2 Restricting Remedies

It is common practice in Switzerland to contractually limit remedies. According to Article 169 of the SIA 118:2013, for example, the employer is initially only entitled to claim rectification of the defect within a reasonable time. Only if the contractor fails to repair the defect within the time limit set the employer is entitled, at its own discretion, either to maintain its insistence upon remediation (on condition that the remediation works do not engender excessive costs in proportion to the employer's interest in rectification of the defect) or to pursue either reduction or rescission (on the condition that removal of the project does not entail the imposition of a disproportionate burden on the contractor and that acceptance cannot reasonably be expected of the employer).

9.3 Sole Remedy Clauses

As stated in **9.2 Restricting Remedies**, it is possible to limit remedies in a way so that one is limited first (Article 169 of the SIA 118:2013). It is also possible to use sole remedy clauses in the sense that only reduction or rectification can be claimed.

9.4 Excluded Damages

There are no damages that are regularly excluded from liability in construction contracts. How-

ever, some contractors try to exclude indirect or consequential damages.

9.5 Retention and Suspension Rights

It is often agreed that the employer has a retention right (eg, under Article 149 of the SIA 118:2013). The employer is entitled to keep 10% of the performance value as security for the performance of the contractor's obligations until acceptance of the project or a part of the project.

9.6 Termination

As long as the project has not been completed, the employer may terminate the agreement at any time in exchange for full indemnification of the contractor. The indemnification shall be equivalent to the consideration to which the contractor would have been entitled for execution of the agreed works, deduction being made for expenses saved by the contractor as a result of the employer's termination (see Article 377 of the Swiss Code of Obligations and Article 184 of the SIA 118:2013).

10. Dispute Resolution

10.1 Regular Dispute Resolution

General Judicial System

In Switzerland, all cantons have their own judicial system. All cantons have set up a double judicial instance system, except for the cantons of Argovie, Berne, St. Gall and Zurich, which have established a Court of Commerce for certain proceedings. All final cantonal decisions may be appealed to the Swiss Federal Supreme Court, provided that certain requirements are met (eg, minimal disputed sum).

Duration of the Proceedings

Ordinary proceedings that are appealed before the Swiss Federal Supreme Court usually take

up to five years. Typically, construction-related proceedings at the first instance are rather time-consuming as they usually include hearings, expert opinions, proof examinations, etc. Depending on the complexity of the case, they can take two years or longer.

Proceedings are often drawn out by interim measures such as expert opinions. 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.

10.2 Alternative Dispute Resolution

Typical Alternative Dispute Resolution

Parties are free to determine the method of dispute resolution, with state court litigation being most commonly used in Switzerland. Domestic arbitration is used less frequently, while international institutional (SCAI, ICC) arbitration is often provided in international treaties.

Domestic and International Arbitration

Even though arbitration is possible in both domestic and international matters in Switzerland, arbitration clauses are typically found in contracts regarding large or complex projects involving international parties.

For domestic matters, Article 353 et seq of the Swiss Civil Procedure Code applies, while international arbitration is regulated in Article 176 et seq of the Federal Act on Private International Law.

SIA Rule 150:2018

The Swiss Society of Engineers and Architects (SIA) has published special arbitration rules (SIA Rule 150:2018) for construction-related contracts that have recently been revised and modernised. In practice, however, they are not (yet) very popular.

Mediation

Switzerland is a country with a rich tradition of mediation. Since 2011, the Swiss Civil Procedure Code has recognised mediation as a form of judicial proceedings at a national level in most civil and commercial cases. There are several leading associations that provide mediation services at a domestic level. These associations also provide lists of certified mediators for civil and commercial mediations. In the field of construction disputes, it is again the SIA that plays a key role; it promotes mediation in its contract templates. Notwithstanding the foregoing, professionally organised mediation has not yet gained a lot of acceptance, maybe because of the good reputation of state courts and arbitration tribunals when it comes to resolving construction disputes by way of settlement.



Law and Practice

Contributed by:

Nick Oury, Christopher Cross, Charles Oliver and Sam Hunt
Herbert Smith Freehills

Contents

1. General p.625

- 1.1 Governing Law p.625
- 1.2 Standard Contracts p.625

2. Parties p.625

- 2.1 The Employer p.625
- 2.2 The Contractor p.626
- 2.3 The Subcontractors p.627
- 2.4 The Financiers p.628
- 2.5 The Designer p.629

3. Works p.629

- 3.1 Scope p.629
- 3.2 Variations p.630
- 3.3 Design p.630
- 3.4 Construction p.631
- 3.5 Site p.631
- 3.6 Permits p.631
- 3.7 Maintenance p.632
- 3.8 Other Functions p.632
- 3.9 Tests p.632
- 3.10 Completion, Takeover and Delivery p.632
- 3.11 Defects and Defects Liability Period p.633

4. Price p.633

- 4.1 Contract Price p.633
- 4.2 Indexation p.633
- 4.3 Payment p.634
- 4.4 Invoicing p.634

5. Time p.634

- 5.1 Planning and Programme p.634
- 5.2 Delays p.634
- 5.3 Remedies in the Event of Delays p.635
- 5.4 Extension of Time p.635
- 5.5 Force Majeure p.635
- 5.6 Unforeseen Circumstances p.636
- 5.7 Disruption p.636

6. Liability p.636

- 6.1 Exclusion of Liability p.636
- 6.2 Wilful Misconduct and Gross Negligence p.636
- 6.3 Limitation of Liability p.637

7. Risk, Insurance and Securities p.637

- 7.1 Indemnities p.637
- 7.2 Guarantees p.637
- 7.3 Insurance p.637
- 7.4 Insolvency p.637
- 7.5 Risk Sharing p.637

8. Contract Administration and Claims p.638

- 8.1 Personnel p.638
- 8.2 Subcontracting p.638
- 8.3 Intellectual Property p.638

9. Remedies and Damages p.638

- 9.1 Remedies p.638
- 9.2 Restricting Remedies p.639
- 9.3 Sole Remedy Clauses p.639
- 9.4 Excluded Damages p.639
- 9.5 Retention and Suspension Rights p.640
- 9.6 Termination p.640

10. Dispute Resolution p.640

- 10.1 Regular Dispute Resolution p.640
- 10.2 Alternative Dispute Resolution p.641

Herbert Smith Freehills (HSF) operates from 24 offices across Asia-Pacific, Europe, the Middle East, Africa and North America, providing premium quality, full-service legal advice. The firm provides many of the world's most important organisations with access to market-leading dispute resolution, projects and transactional legal advice, combined with expertise in numerous global industry sectors. It has been advising on Middle East transactions and disputes for over 40 years. Operating from offices in Dubai and

Riyadh, the firm has a team of approximately 35 lawyers (including ten partners and two of counsel) in the region, delivering a full service across the Middle East and beyond. Having worked on some of the largest transactions and most high-profile disputes in the region, representing governments, sovereign wealth funds, major corporates, banks and professional services organisations, HSF has an in-depth understanding of Middle East business culture and practices and the local civil and sharia systems.

Authors



Nick Oury is an Oxford University graduate and English-qualified lawyer, specialised in dispute resolution in the construction and infrastructure sector, with a focus on

arbitration. Based in Dubai and with 15 years' experience across three continents, Nick has led HSF's Middle East contentious construction practice since 2019, advising employers and contractors on their claims with a view to achieving a favourable settlement or, failing that, a successful outcome in arbitration or litigation. Nick has acted on international arbitrations under the DIAC, ICC, DIFC-LCIA, LCIA and ADCCAC rules arising out of projects in all industry sectors and involving all major forms of procurement.



Christopher Cross has two decades of experience successfully completing major infrastructure projects around the globe, and brings a wealth of experience across a diverse

range of sectors. Prior to joining HSF Christopher worked in Saudi Arabia for the National Centre for Privatization (NCP), where he was a key member of the legal transaction team providing advice to the Supervisory Committees, the Ministry of Finance and contracting authorities on the delivery of PPP projects in aviation, water, waste, real estate, rail, healthcare, infrastructure (including bridges), ports, and technology to ensure compliance with PPP Manual and international best practice.



Charles Oliver is a senior associate in the Projects and Project Finance group specialising in major energy (conventional and renewable), transport and infrastructure

projects. Charles joined HSF's Dubai office in 2020, and has experience acting for procurers, borrowers, lenders, developers and operators across a range of sectors, including energy, transport, infrastructure, water and oil and gas in the Middle East and Europe.



Sam Hunt is an Australia-qualified Associate in HSF's Dubai disputes practice with a focus on complex, large-scale construction and engineering disputes. He has a particular

focus on cross-border construction and infrastructure disputes. Sam has acted on a wide range of disputes arising out of major infrastructure and mining projects, in particular disputes concerning mining infrastructure, road, rail and commercial real estate. Sam has advised on arbitrations under the LCIA, DIAC and ACICA rules and litigious matters in the courts of the DIFC, Queensland, South Australia and Papua New Guinea.

Herbert Smith Freehills LLP

Dubai International Financial Centre
Gate Village 7
Level 4
Dubai
PO Box 506631
United Arab Emirates

Tel: +971 4 428 6300
Fax: +971 4 365 3171
Web: www.herbertsmithfreehills.com



**HERBERT
SMITH
FREEHILLS**

1. General

1.1 Governing Law

The UAE consists of “onshore” and “offshore” jurisdictions.

Onshore UAE

Onshore UAE refers to the civil law jurisdiction governed by the federal laws of the UAE and the laws of the seven Emirates, these being Abu Dhabi, Ajman, Dubai, Sharjah, Umm Al Quwain, Ras Al Khaimah, and Fujairah. The primary legal instruments governing construction activity in onshore UAE are Federal Law No. 5 of 1985 (the UAE Civil Code) and Federal Law No. 50 of 2022 (the UAE Commercial Code).

There are several provisions within the UAE Civil Code which apply specifically to construction (or *muqawala*) contracts. For the most part, these are non-mandatory provisions which apply where the relevant construction contract is silent.

Offshore UAE

Offshore UAE refers to the Dubai International Financial Centre (DIFC) and the Abu Dhabi Global Market (ADGM). Both are common law jurisdictions with their own civil laws and court systems.

In the DIFC, construction contracts are primarily regulated by DIFC Law No. 6 of 2004 (the DIFC Contract Law).

By contrast, the ADGM adopts the common law of England (including the principles and rules of equity) and a number of English statutes, subject to certain modifications or amendments.

1.2 Standard Contracts

As in many jurisdictions, construction projects in both the onshore and offshore UAE often

adopt standard form contracts published by the International Federation of Consulting Engineers (FIDIC). In particular, it is common to see the FIDIC Red Book and White Book used or adapted for UAE based projects.

Additionally, there are a number of bespoke local standards adopted by government departments. For instance, the Abu Dhabi government has adopted the Abu Dhabi Government Conditions of Contract, which are mandated for use by Abu Dhabi government departments when procuring construction or design-and-build projects, respectively, in the Emirate. While these standards are based on the 1999 FIDIC Red and Yellow Books, they have been amended to shift risk from the employer to the contractor.

It is also common for local and international developers and contractors to adopt their own, internal, standard contracts as a starting point for contract negotiations. At times, these internal standards are based on the FIDIC contract suite, but they are often heavily amended based on the jurisdiction in which the contracts will be used and each entity’s own individual requirements.

2. Parties

2.1 The Employer

There are a wide range of companies and institutions that act as employers on UAE-based construction projects. For example, it is common to see the following:

- a local residential developer acting as an employer on large-scale housing developments;
- a local or international energy company acting as an employer on an independent water

- and power plant or other renewable energy projects; and
- a governmental or semi-governmental entity acting as an employer on public utility and transportation projects, including rail and road projects.

Obligations of the Employer in the UAE

Aside from making payments and assessing any contractual claims submitted by the contractor, an employer is usually responsible for high-level project administration, such as obtaining necessary permits (for instance, building permits, building completion certificates, etc), granting necessary site access to the contractor and any subcontractors, and issuing certificates during and at the conclusion of a project (such as certificates of practical completion).

An employer may also take on responsibilities relating to the operational health and safety issues on a project. That said, it is common for such responsibility to be contractually passed downstream to the contractor (to the extent that it is possible to do so given that tortious liability cannot be contractually limited in the UAE).

Rights of the Employer in the UAE

As with any construction project, an employer is entitled to receive a completed project that is designed and/or constructed according to the agreed terms.

Where a contractor fails to meet the contractually defined expectations of a project, an employer will usually have various contractual rights which may be exercised to protect its commercial interests, including the rights to step in, set off, and to make demands against any bank guarantees and performance bonds. Additionally, where the works are defective and a contractor fails to remedy their work following notice to do so, the

employer may also (subject to agreement to the contrary) request the court to allow them to hire a separate contractor to complete the works at the original contractor's expense (Article 877 of the UAE Civil Code).

The Employer's Relationship with Contractors, Subcontractors and Financiers

As in most jurisdictions, the employer's predominant relationship in the UAE will be with its contractor, and obligations owed by the contractor to the employer will then typically flow down to one or more subcontractors. On many projects, particularly large-scale or complex projects, the employer may also have a relationship with external financiers, who often have rights to ensure the delivery of the project, such as step-in rights in the event of a default by the contractor, or rights to take over the project if the employer becomes insolvent.

2.2 The Contractor

On PPP projects, it is very common to see special purpose vehicles ("SPVs") specifically established to submit a bid to the relevant procuring entity with such SPVs often being comprised of multiple international developers. Also commonly seen are international construction companies, specialist contractors with expertise in specific project types (for instance, some contractors may be particularly suited to the engineering and construction of oil and gas facilities) and local contractors.

Obligations of the Contractor in the UAE

The primary obligation of a contractor in the UAE is to perform the works with the due skill, care, and diligence required under the contract, industry standards, and UAE law. Additionally, contractors are typically required to ensure the timely completion of a project. As contractors sit between the employer and subcontractors in

the contractual “chain”, they typically take on the responsibilities to:

- manage and supervise subcontractors completing work on the project – both from a time and quality perspective; and
- pass claims and change requests received from subcontractors upstream for consideration by the employer.

Given that contractors often assume responsibility for the site, it is common to see contractors having obligations in respect of health, safety, environmental regulations, and compliance with local labour laws.

Rights of the Contractor in the UAE

Contractors will have the right to expect timely and complete payment for work completed (subject to the specific payment terms of their contract). Some contractors may also be granted the right to rely on project specifications and design provided by the employer, although this is commonly excluded in UAE construction contracts and, due to the imposition of decennial liability under the UAE Civil Code, it is recommended in any event that contractors complete a thorough technical review of design documents before commencing construction.

During the course of a project, the contractor will typically enjoy the right to access the construction site or sites so that they may carry out contracted works without interference. To the extent that access is not granted or the project is delayed, changed, or varied in any way by the employer, contractors may also exercise their right to claim additional costs and extensions of time. However, where a delay or change is the fault of the contractor, such remedies are typically unavailable.

The Contractor's Relationship with Employers, Subcontractors and Financiers

The role of the contractor on a construction project can often be administrative, as sitting between the employer and the subcontractors will often see the contractor receiving and passing on notices both upstream and downstream.

While the engagement between a contractor and project financiers is typically limited, there are certain circumstances in which a financing party may be able to exercise rights to force the employer to terminate its agreement with the contractor or to step-in and replace the employer, which will often require a novation of the subcontract to the financier or a party selected by the financier to continue the project.

2.3 The Subcontractors

There is a wide variety in the types of companies that may act as subcontractors in the UAE, and the specific subcontractors engaged will depend upon the requirements of each project. However, in broad terms, subcontractors will often be as follows:

- *design contractors* – generally architects and engineers; these tend to be contractors engaged directly by the employer as “consultants” or by the contractor as subcontractors;
- *labour contractors* – these are typically involved in the completion of basic civil construction work; in the UAE, labourers may be either skilled or unskilled, and will in all cases be supported by more specialised trade or speciality contractors;
- *trade contractors* – contractors from all construction “trades”, such as electricians, plumbers, and carpenters;
- *specialty contractors* – those completing more niche services such as complex steel-work, landscaping, HVAC installation, or

- completion of internal fit-outs in specialised projects such as hospitals; and
- *service contractors* – companies offering services such as scaffolding hire, portable site office rentals, and equipment hire.

Obligations of the Subcontractor in the UAE

As with head contractors, subcontractors are typically required to perform the works under their contract with the due skill, care, and diligence required under the contract, industry standards, and UAE law. Subcontractors will also have obligations in respect of timely completion of work, and will usually be expected to promptly raise any issues or concerns with their work or the project more broadly to the attention of the head contractor so that they may be resolved.

Rights of the Subcontractor in the UAE

The rights of a subcontractor are largely the same as those of a head contractor. For instance, subcontractors have the right to:

- receive timely payment for their work pursuant to the conditions of their contract;
- claim variations, extensions of time, or costs arising from changes to their scope of work or unforeseen delays outside their controls; and
- access the construction site to perform contracted works (assuming site access is necessary for the relevant scope of works, as some subcontractors may work from a separate site or office).

The Subcontractor's Relationship with Employers, Contractors and Financiers

As subcontractors are engaged by the contractor, their engagement with the employer is typically limited. Subcontractors will usually have very limited exposure to financing parties.

2.4 The Financiers

Various types of companies and institutions operate as financiers in respect of UAE based projects, including banks and lending institutions, private equity firms, wealth funds with infrastructure portfolios, and the federal or Emirate governments and government owned investment corporations such as the Investment Corporation of Dubai.

Obligations of the Financier in the UAE

Financiers provide funding for the project, sometimes in the form of a single injection of funds, although more commonly through milestone-based disbursements (for instance, a certain amount of money will be disbursed during the design phase, with additional funds throughout construction phases).

Rights of the Financier in the UAE

It is common for financiers to have extensive rights to monitor and guarantee the progress of the project, including rights to step in and take over the project as needed. Financiers also commonly have the right to enforce security interests by calling on bonds or bank guarantees if doing so becomes necessary.

While not all financing arrangements require repayment of the principal financing sum during construction (although many will), it is common for financiers to have rights to collect an income in respect of revenue-generating assets such as energy generation facilities and toll roads.

The Financier's Relationship with Employers, Contractors and Subcontractors

The financier's predominant relationship is with the borrowing party, which will typically be the employer in a construction context. While the financier may have some limited engagement with the contractor, this is likely to be limited to

project oversight and the financier will not be likely to engage in day-to-day operations or with subcontractor parties.

2.5 The Designer

As discussed in 2.3 **The Subcontractors**, designers will typically be architectural or engineering firms and will be responsible for the preparation of design documents and specifications necessary to produce a structure that complies with employer requirements and is structurally sound. Certain projects may also require more niche design expertise, at which point it is possible for companies providing services such as landscaping and water feature design to be retained.

Obligations of the Designer in the UAE

Designers are obligated to develop design documents, including drawings, specifications and plans, that meet project and regulatory requirements. Designers will typically engage with both the employer and subcontractor throughout the project to ensure that the end result complies with the employer's needs and is able to be built by the contractor.

Rights of the Designer in the UAE

A designer is entitled to receive compensation for their design services, which may be a lump-sum payment in the event of a limited scope of design (such as design of internal signage for a residential apartment building) or on ongoing payment terms in the case of more key design contractors such as the architect.

Subject to the terms of their contract, some architects may have rights over the intellectual property in their design work. However, designers will typically be given moral rights over their design in accordance with Articles 5 and 31(3) of Federal Decree Law No. 38 of 2021 (the UAE Copyright Law).

The Designer's Relationship with Employers and Contractors

Under UAE law, the designer has a fairly unique relationship with the contractor. Due to the existence of "decennial liability" under the UAE Civil Code, both the designer and contractors are jointly liable to the employer for a period of at least ten years for total or partial destruction of buildings or fixed constructions designed by the designer and erected by the contractor in accordance with that design (Art. 880 of the UAE Civil Code).

3. Works

3.1 Scope

Typically, a project's scope of works will be determined by the various high-level documents prepared by the employer which outline the objectives of the project and its minimum requirements. While the employer will usually be responsible for the accuracy of such documents, there have been instances where contractors have agreed to ensure that the works are completed in accordance with a particular industry standard or a level of care, regardless of the accuracy of the employer's documentation. This is on the basis that the contractors are better placed to bear such risks and are engaged for their experience and skill. Consequently, it is common for contractors to accept certain levels of design risk even if they had no input in the preparation of the design.

There have also been instances of contractors taking on design responsibility, in which case design subcontractors may prepare detailed design documentation based on the high-level documents provided by employers. This is popular among employers looking for a "single point" of responsibility (ie, the contractor), rather

than having to manage multiple contractors for different packages of work. It is therefore seen most commonly in EPC contracts.

Key documents used to define the scope of works in the UAE include the following.

- *Programme of requirements* – the programme of requirements is a document that sets out both the functional and operations needs for a project. This is the “foundational” document of any project, and will be the guide for development of more detailed technical documentation at a later stage.
- *Technical specifications* – these present the requirements and standards of quality, performance and materials that are to be used on a project, and will often go into detail on considerations such as building materials, construction methodology, installation requirements, and quality control procedures.
- *Design drawings* – design drawings are graphical representations of a project, including spatial layout, dimensions, architectural and structural elements, and other key details necessary for project construction.
- *Bill of quantities* – the bill of quantities is an itemised list of quantities and types of construction materials, labour, and equipment necessary for construction works and is used to calculate the costs and resourcing requirements of a project.

Specialist financial and technical advisors are frequently engaged by employers to assist in the preparation of the above documents. Indeed, on large-scale projects which are financed, multiple advisors will be engaged acting for procurers, sponsors and lenders.

3.2 Variations

Parties are free to agree on their respective contractual rights and obligations relating to variations.

Where a variation is requested by the employer, the method for determining the scope and price will depend entirely on the form of contract. In an EPC contract, generally the contractor will be requested to indicate the cost and time implication of the variation, and the employer (or engineer or other representative) will determine the additional cost and any extension of time. Contracts usually permit the contractor to request a variation, with the determination of time and cost determined in the same way.

If there is no pre-agreed method of valuing a variation, Articles 885 and 888 of the UAE Civil Code allow the contractor to receive fair reimbursement for the works performed. However, such reimbursement is usually limited to direct cost.

3.3 Design

While the division of design responsibility as between the employer, designer and contractor will vary from project to project, it is common for the employer to provide the contractor with its minimum requirements and, more often than not, detailed design specifications. Additional design work may be carried out by the employer's design consultant or, in some instances, the contractor or a subcontractor.

In large-scale EPC contracts, as in other jurisdictions, the responsibility for the design process is almost entirely on the contractor.

Even if the contractor is engaged on a “build-only” basis, the imposition of decennial liability under Article 880 of the UAE Civil Code results

in the contractor being jointly liable with the designer for a period of ten years (or a longer agreed period), in the event of any partial or total destruction of the works or the presence of defects that threaten the structural integrity of the works. As such, contractors should always review and verify whether the design documents are appropriate and fit for purpose, even if they are not directly involved in the design work. Insurance policies covering such risks are available in the market and, as far as we are aware, effected and maintained for all projects.

3.4 Construction

As set out in 2. Parties each of the employer, contractor, and subcontractor take on distinct roles in the construction of a project.

At a high level, the following will be required:

- the employer will be responsible for obtaining necessary permits for construction, providing site access, and making payments to the contractor to ensure continued cashflow;
- the contractor will be responsible for liaising between the employer and the subcontractors and ensuring execution of the works in accordance with the employer's specifications and requirements (subject to buildability issues in the same); and
- the subcontractors will be responsible for specific workstreams instructed by the contractor in line with the employer's requirements – for example, installation of electrical wiring in a new office building, or plumbing works in a residential tower; the contractor's supply chain is often subject to oversight from the employer, particularly in relation to critical components of the works.

3.5 Site

Each party involved in a project will usually bear some responsibility for the site. Broadly speaking, the employer's responsibility is to provide access to the site and, to the extent possible, to inform the contractor of any pre-existing site conditions of which it is aware (for instance, pollution, underground obstacles, and geotechnical conditions). The contractor will typically inspect the site before entering any contract for construction works to satisfy itself as to the site conditions. In the event of latent site conditions which could not have been discovered through reasonable inspections, the contractor will typically be entitled to the associated delays and/or costs.

Once the employer provides the contractor with access to the site, responsibility and liability connected with the site (including operational health and safety liability) will typically pass to the contractor, subject to any limitations of liability provided in the relevant contract. By way of example, projects procured by government entities in Abu Dhabi often provide relief to contractors for any adverse site conditions encountered in the first 12 months of construction, as this is when such conditions are most likely to be discovered. However, this is not universally applied across the region.

3.6 Permits

There are several permits required to complete construction works in the UAE. Typically, the process of obtaining necessary permits is the responsibility of the employer, although the task of obtaining "no-objections certificates" will usually fall to the contractor. While it is not possible to provide a comprehensive list of permits in the UAE, as these will vary between different types of projects and depend upon the rules of the Emirate where construction will take place, most

projects will require a building permit and (on completion) a Building Completion Certificate. It is also very common to need permits for civil works and for utility connections such as water and sewage – although this, again, depends on the type of project.

3.7 Maintenance

During the defects liability period, it will typically fall to the contractor to maintain the works, including repair of any damage. However, some employers may separately elect to enter a contract for maintenance of the works, commencing immediately after practical completion. In these circumstances, the contractor may only be involved in rectification of major defects, and the maintenance contractor might handle more “everyday” maintenance activities.

After the conclusion of the defect liability period, it is common for employers to hand over maintenance obligations to a dedicated maintenance contractor, who may also be responsible for operation of the works under an operation and maintenance contract. More specialist maintenance for mechanical equipment and technology may be separately contracted to the manufacturer of the equipment or a specialist maintenance contractor.

3.8 Other Functions

Projects in the UAE will see the procurer engage the project company in respect of a variety of functions. In a PPP arrangement, the Project Company is often responsible for the finance, design, procurement, construction, operation and maintenance of the project.

On certain projects (for example, wind and gas projects) it is common to see the original equipment manufacturers of specialist components (ie, turbines, etc) engaged pursuant to a long-

term service agreement (which runs concurrently with the overarching operation and maintenance contract) to maintain such specialist components given their bespoke nature.

However, the specific functions for which a party is responsible will ultimately depend on the project, the employer’s risk tolerance and the nature of its business.

3.9 Tests

Tests for completion of works are typically undertaken by the contractor (who will likely also be responsible for remedying any defects identified during testing). The testing structure varies from project to project, and different projects have different tests; by way of example, waste to energy projects have “must-run” tests which are not common in solar projects. For more specialised mechanical, electrical, and technological items an employer may separately engage a specialist third party to provide commissioning and testing services.

3.10 Completion, Takeover and Delivery

Following practical completion of a project and the commissioning and testing of the works, a taking-over certificate will typically be issued by the project engineer, at which point the employer will take over the works.

If the employer begins to use any part of the works before a taking-over certificate is provided, this may constitute a “tacit takeover” and result in the employer becoming liable for the site in any event. Provision to this effect can be found in the commonly used 1999 FIDIC Red Book, in which clause 10.2 provides for tacit takeover. However, where employers prepare their own bespoke forms of particular conditions such a clause is frequently amended along with

concepts such as deemed acceptance which are more contractor friendly.

Per Article 884 of the UAE Civil Code, where the employer fails, without reasonable cause, to take over the works once completed by the contractor, the employer will have no claim against the contractor during that period if the work “perishes in the hands of the contractor or becomes defective, without any trespassing or neglect from the latter”.

After takeover, the employer will typically return parts of any retention monies and bank guarantees or performance bonds, with the remaining balance usually returnable at the conclusion of the defects liability period.

3.11 Defects and Defects Liability Period

The defects liability period typically commences upon issue of the taking over certificate and typically lasts for 24 months. That said, it is open to the parties to agree to a shorter or longer period.

During the defects liability period, the contractor remains obligated to remedy, at its own cost, any defects or to complete any works that are found to have been left incomplete. If the contractor refuses to remedy or complete the works, the employer will typically have a right to:

- remedy the defect or have the works completed by a third party at the contractor's expense;
- exercise any rights of set-off in respect retention sums; and/or
- call upon remaining bank guarantees or performance bonds.

It is common for contracts in the UAE to extend the defects liability period in respect of any specific sections of the works that are found to be

defective and then remedied during the defects liability period. Often such extensions are for periods commensurate with the original defects liability period but subject to an overall limit (for instance 48 months from issuance of the taking over certificate).

4. Price

4.1 Contract Price

Most construction contracts in the UAE will be priced on a lump sum or remeasurement basis (ie, payment under a schedule or rates or bill of quantities). While some parties may elect to use a costs-plus or “reimbursable” method to establish the contract price, this method is unusual in the UAE.

Typically, payment will be contingent on inspection and certification of works as “complete” by the contract administrator. This can be on a fixed periodic basis (for instance every month or every quarter) but is also commonly completed on a milestone basis, particularly for complex projects involving multiple design and/or construction phases.

4.2 Indexation

It is uncommon for contracts in the UAE to provide for indexation of prices. Indeed, in respect of lump sum contracts, Article 887 of the UAE Civil Code provides that, subject to any agreement to the contrary, the contractor will have no claim to an increase in price required for execution of the works.

In the event of a large fluctuation in price, (again subject to agreement to the contrary) Article 886 of the UAE Civil Code allows the employer (once informed by the contractor) to “release himself from the contract and stop the execution with-

out delay and pay the contractor the cost of the work done by him estimated in accordance with the terms of the contract". If the price increases significantly and the contractor does not inform the employer, the contractor will forfeit any right to recover the increased expenses of the work.

Accordingly, the position at law is particularly friendly to employers and seeks a greater proportion of risk sit with the contractor in the event the relevant contract does not provide for indexation.

Indexation is only usually seen on projects where a certain element of the price is uncertain or applicable over a long duration. This mechanism is often resisted by employers as it undermines (to an extent) the "fixed price" approach and creates uncertainty as to the total costs at the outset.

4.3 Payment

While payment mechanisms vary project to project, construction contracts for UAE projects frequently require the employer to make advance payments and/or progress/interim payments to assist the contractor with its cashflow management. The use of milestone payments is also common in UAE construction contracts, tying payments to the contractor to the completion of contractual milestones to encourage timely progress in line with the programme.

In the event of non-payment, contractors and sub-contractors are usually entitled to suspend works.

4.4 Invoicing

Invoices in the UAE are commonly issued by either email or as a hard copy; however, many international employers and contractors will additionally or alternatively use invoicing tools

built into internal construction project management systems.

5. Time

5.1 Planning and Programme

The employer usually initiates the planning process by providing high-level documentation relating to the project objectives and technical specifications to the contractor. However, the contractor will typically be responsible for the development of a detailed construction methodology and a programme that accords with the timing requirements of the employer. It is not uncommon for an in-house or external project manager to be retained to assist in day-to-day coordination of activities in line with the construction programme. Parties are also increasingly using project management software to coordinate site activities.

5.2 Delays

There is no automatic entitlement to additional time under UAE law. As such, the allocation of time-related risk is a matter for the parties agree.

In the event of delays, the contractor is typically required to notify the employer of the event or circumstance giving rise to the delay and provide the details of any extension of time and/or costs claimed.

Following the receipt of such notice, the employer will usually be required to review and make a determination of the contractor's claim, either by issuing a variation order to extend any time for completion or by rejecting the contractor's claim. Employers are usually required to make such determination within a certain period of time (although some contracts do not require response within a set period).

For any time-related costs arising from delay events which are on the employer's account, the contractor is usually entitled to claim such costs (except in the case of force majeure), except for indirect cost.

Where there is a finding of concurrent delay, the onshore UAE courts are likely to apportion the liability between the parties by applying the provisions of the UAE Civil Code, including Article 246 (good faith), Article 290 (power to reduce damages if damage caused by claimant) and Article 291 (power to apportion liability).

By contrast, the courts of the DIFC and the ADGM are more likely follow the English law approach by awarding additional time but not prolongation costs to the contractor.

5.3 Remedies in the Event of Delays

In the case of delays by the contractor, the employer may be able to claim liquidated damages (which, pursuant to Article 390(2) of the UAE Civil Code, must be equivalent to the prejudice suffered). The employer may also be able to call upon any performance guarantee or terminate the contract, particularly if the delay constitutes a fundamental breach of contract or in circumstances where a longstop date is reached.

If the delay is caused by the employer, the contractor will typically be entitled to an extension of time and costs associated with the delay.

5.4 Extension of Time

Parties are free to agree on the procedure relating to extensions of time. However, as a general rule, a contractor will typically need to provide the employer with a notice requesting an extension of time, within a set number of days from becoming aware of an event of delay or a change

that will increase the time required to complete the project.

It is common for construction contracts to include provisions which state that the contractor's entitlement to an extension of time is conditional upon strictly complying with the notification regime, and that a failure to comply will result in a time bar. However, while UAE law recognises the parties' freedom to contract, there are various provisions in the UAE Civil Code which could support the contractor's attempts to overcome the potentially harsh outcomes of a time bar. In particular, it is common to see contractors rely on provisions such as Article 106 (abuse of rights) and Article 246 (good faith).

Extensions of time are often measured against the contract programme. It is also common for the employer or contractor to retain a delay consultant to review any entitlement to additional time from a technical perspective.

5.5 Force Majeure

Pursuant to Article 273 of the UAE Civil Code a party intending to rely upon force majeure to excuse non-performance of a contractual obligation must prove the following:

- that the event was unforeseeable;
- that the event made it impossible to perform the obligation;
- that the event could not have been avoided; and
- that the event was not caused by the obligor.

While force majeure is legislatively derived in the UAE, it is possible for parties to agree to the scope of what will constitute "events of force majeure" – provided nothing in such agreement contradicts the express terms of the UAE Civil

Code (for instance, parties cannot agree that impossibility of performance is not required).

Typically, agreements will contain a list of events that will qualify as events of force majeure, for instance: war, extreme inclement weather, natural disasters, or pandemics. However, parties are ultimately able to agree to a clause that is as broad or as narrow as they desire, and a common method of constraining application of a force majeure clause is to impose a geographical limitation (for example “inclement weather events inside the UAE”, rather than just “inclement weather events”).

In the event of temporary, partial or total impossibility of performance, the UAE Civil Code confirms that force majeure can be established. Where impossibility is total, the corresponding obligation is extinguished and the contract will be rescinded. Where the impossibility is only partial, the contract will be extinguished to the extent of the impossibility. In all instances, the force majeure will only excuse non-performance of affected obligations.

If a party to a construction contract can establish that an event of force majeure resulted in delay, the default position in the UAE is that said party will be entitled to additional time, but not costs, for that delay.

5.6 Unforeseen Circumstances

Parties are free to agree on the allocation of risk associated with unforeseen circumstances.

For example, when it comes to site-related risks, projects procured by government entities in Abu Dhabi often provide relief to contractors for any unforeseen adverse site conditions encountered in the first 12 months of construction, as this is when such conditions are most likely to be dis-

covered. However, this is not universally applied across the region.

One exception to this rule is the designer and contractor’s decennial liability under Article 880 of the UAE Civil Code, which does not require any element of fault or foreseeability to be established.

5.7 Disruption

There is no concept of “disruption” under UAE law, and claims for disruption will typically be a matter for contract. However, in the absence of an express disruption clause in a contract, contractors in the UAE may be able to claim damages in respect of a disruption by bringing a general claim for damages if the disruption is caused by the employer’s breach of contract. This places an evidentiary burden on the contractor, who must be able to show a nexus between the employer’s breach of contract and the damage suffered.

6. Liability

6.1 Exclusion of Liability

The UAE Civil Code specifies a limited number of liabilities that cannot contractually be excluded. These include the following:

- decennial liability for partial or total collapse of works or a defect that threatens the integrity of those works (Article 880);
- fraud or gross negligence (Article 383); and
- personal injury, criminal acts or death (Article 296).

6.2 Wilful Misconduct and Gross Negligence

The concepts of wilful misconduct and gross negligence exist in the UAE and are governed

under the UAE Civil Code. Specifically, under Article 383, any person who is obligated to “preserve a thing or to act with prudence in ... performance” of an obligation is required to exercise the care of a reasonable person, and failure to exercise such care gives rise to liability. Additionally, Article 383 specifies that liability for gross negligence or fraud cannot be excluded.

6.3 Limitation of Liability

Subject to the liabilities that expressly cannot be contractually excluded in the UAE (as detailed in 6.1 Exclusion of Liability), it is generally open to parties in the UAE to agree to contractual limitations of liability, including liability for consequential and indirect loss.

7. Risk, Insurance and Securities

7.1 Indemnities

It is common in the UAE for a contractor to indemnify the employer for any losses (including indirect losses) arising out of works completed by the subcontractors or other third parties. It is less common, but not unheard of, for the employer to indemnify the contractor for loss.

Contracts usually, as a matter of course, contain overall caps on the contractor’s liability under the relevant contracts subject to customary exclusions (breach of confidentiality, IP infringement, amounts recovered under insurances, etc). Whether indemnities sit outside the liability cap is often hotly negotiated.

In any event, it is important to note that UAE law does not clearly distinguish between assessing damages on an indemnity basis as opposed to a breach of contract basis and may require a party to prove breach of contract to recover its losses.

7.2 Guarantees

Guarantees in the UAE are a matter for contract and will typically take the form of a bank guarantee. Typically, bank guarantees for UAE based construction projects will be for between 5% and 10% of the contract sum, with 50% of that amount returned to the contractor following practical completion and the remaining 50% returned upon conclusion of the defects liability period. While it is common in many jurisdictions for contractors to injunct attempts by the employer to call on bank guarantees, courts are unlikely to award such relief in the UAE, particularly where a bank guarantee is expressed to be “on demand”.

7.3 Insurance

As in many jurisdictions, construction contracts in the UAE will typically require the parties put in place a variety of insurance policies. Common policies include “construction all risk”, “third-party liability” and “professional indemnity” policies. There are typically also separate policies of insurance for employees and equipment.

7.4 Insolvency

Typically, if a party becomes aware of the insolvency of a counterparty in a UAE construction contract, that party will become entitled to terminate the contract. It is also common for parties to stop making payments under the contract and to attempt to call on any remaining bank guarantees to try and mitigate their potential losses, particularly if that party is an unsecured creditor.

7.5 Risk Sharing

Specific risk allocations are a matter of contract, and will be determined on a project-by-project basis. As a general rule of thumb, true “risk sharing” has not historically been a common practice in the UAE, with employers preferring lump-sum contracts due to the protection it affords under

Article 887 of the UAE Civil Code (which prevents contractors from claiming increases in contract price where they have agreed to a lump sum). However, the past few years has seen a growing number of parties agreeing to contracts with “pain share gain share” provisions, although these are still fairly uncommon.

8. Contract Administration and Claims

8.1 Personnel

In the UAE, all construction projects must abide by Federal Decree Law No. 33 of 2021 (the UAE Labour Law), which:

- prevents employees from working more than eight hours per day or 48 hours per week unless they are a manager or supervisor (Articles 65 and 72);
- entitles Muslim employees to reduced working hours during Ramadan (Article 65);
- prevents employees from completing more than two hours of overtime per day unless necessary to prevent substantial loss or a serious accident (Article 69); and
- requires employers provide appropriate safety measures to protect employees against occupational injuries and diseases (Article 91).

Additionally, many standard form contracts in the UAE will contain express provisions in respect of personnel, including terms as to payment and housing.

8.2 Subcontracting

Pursuant to Article 890(1) of the UAE Civil Code, a contractor is permitted to entrust the whole or part of the work to a subcontractor unless the contract with the employer prohibits doing so or the nature of the work requires the contractor to

complete it themselves. Article 890(2) confirms that the contractor remains wholly liable to the employer in respect of work completed by its subcontractors (although it does not prohibit the contractor from claiming from its subcontractors in kind) and Article 891 prohibits subcontractors from claiming against the employer unless the contractor assigns the right for them to do so.

8.3 Intellectual Property

Typically, a contract will require the designer to either relinquish its intellectual property rights in its designs prepared for a project or, more commonly, to grant the employer a perpetual, irrevocable, unlimited license to use the intellectual property with a right to sub-licence. Such arrangements will typically also require the designer to give the employer the exclusive use of the design.

Article 31(1) of the UAE Copyright Law confirms that architectural designs will belong to the property owner unless otherwise agreed. However, Article 31(3) provides that they may not be changed to preserve the moral rights of the architect.

It is common for contracts to include an agreement to indemnify the employer against any liability it may incur in the event of any infringement of the intellectual property rights of a third party (for instance, a claim against the employer arising due to an architect using another architect's design).

9. Remedies and Damages

9.1 Remedies

Pursuant to Article 257 of the UAE Civil Code, “the principle in contracts is the assent of the parties” and, accordingly, parties are gener-

ally free to agree to an array of remedies in line with general principles of contractual freedom, subject to any mandatory laws or public policy considerations.

Broadly speaking, parties in the UAE will typically agree to the same suite of contractual remedies seen on construction projects the world over. For employers, this will typically mean liquidated damages, demands on bonds, withholding of payment, exercise of set-off rights, and termination. For contractors, remedies will typically be confined to extension of time, suspension of work, termination, and general contractual damages.

9.2 Restricting Remedies

As noted in **9.1 Remedies**, parties in the UAE have general freedom of contract and can agree (or limit) remedies provided doing so is not contrary to any mandatory law or public policy consideration. Indeed, parties should always ensure that any limitation to available remedies is reasonable and at all times in line with the overarching requirement to deal in good faith.

While parties will not typically prohibit specific forms of remedy, it is common to agree to limitations of liability (subject to the restrictions explained in **6.1 Exclusion of Liability**) that broadly carve out liability for, by way of example, consequential loss. Such clauses will also typically set a cap on damages, which is commonly 100% of the contract sum, but may be lower depending on the negotiating power of the parties.

9.3 Sole Remedy Clauses

Sole remedy clauses are commonly seen in construction contract in the UAE but are commonly a point of contention when issues arise.

Indeed, while parties generally have freedom to contract, this is subject to the requirement that contract terms cannot contravene any mandatory law or public policy. As such, parties entering contracts governed by UAE law should take care when drafting a sole remedy clause to ensure it is not later found to be invalid.

In particular, parties should be aware of Article 390 of the UAE Civil Code. While Article 390(1) allows parties to agree in advance to an amount of damages (thereby giving rise to liquidated damages under UAE law), Article 390(2) requires these damages to be “equal to the prejudice”. To this end, parties should avoid drafting or agreeing to any sole remedy clause that could give rise to claims of unjust enrichment.

9.4 Excluded Damages

Under UAE law, parties are generally free to agree to contractual indemnities against loss of profit, loss of future profits, or indirect or consequential loss provided doing so does not contravene any mandatory law or public policy.

As an example of liability that cannot be excluded, Article 880 of the UAE Civil Code is a mandatory provision that makes the architect and contractor jointly and severally liable for the total or partial destruction of buildings or other fixed constructions erected by them for a period of 10 years (unless the construction is not intended to last more than 10 years). To this end, a liability cap broadly excluding liability for the total or partial destruction of a building would not be permitted under UAE law.

Article 296 of the UAE Civil Code prevents parties from excluding tortious liability. As such, a provision excluding tortious liability in a contract governed by UAE law would not be valid.

9.5 Retention and Suspension Rights

Retention

It is common for parties to a construction contract in the UAE to agree to employer retention rights. Typically, as in many jurisdictions, 10% of each interim payment made to a contractor will be retained by the employer, with 50% of the total retention released after takeover and the remaining 50% released after expiration of the defects liability period.

Suspension

Typically, parties in the UAE will agree to suspension rights, with the exact scope and terms of such rights agreed under contract and accordingly different from project to project. In the absence of an express provision in the contract, there is some support for suspension at law under Article 247 of the UAE Civil Code, which gives a right of non-performance to a party in the event their counterparty fails to fulfil its contractual obligations.

9.6 Termination

Article 267 of the UAE Civil Code explains that a valid and binding contract may only be revoked, modified or rescinded in the event of (i) mutual consent, (ii) court order or (iii) a provision of law. Article 267 is expressed in almost identical terms in Article 892 of the UAE Civil Code (within the *muqawala* section).

The mutual consent of the parties can be expressed within the contract itself, provided it is expressed with sufficient clarity that termination occurs automatically by the Employer's notice and that there will be no need for a court order or a further notice.

Termination for convenience clauses are also generally permissible, although are occasionally challenged on the basis of Article 218 of the UAE

Civil Code, which states that a contract is not binding if there is a condition that a party may cancel it without mutual consent or an order of the court.

Parties should also be aware of the overarching obligation of good faith implied into all contracts governed by UAE law by Article 246 of the UAE Civil Code and avoid terminating a contract in any circumstances where doing so is or could be construed to be in bad faith or an abuse of rights (UAE Civil Code 106).

The parties are generally free to agree the terms on which each party is compensated in the event of termination.

10. Dispute Resolution

10.1 Regular Dispute Resolution

Onshore UAE

In the onshore context, construction disputes will be adjudicated by the local courts. Each of the seven Emirates has the right under the UAE Constitution either to participate in the Federal Judiciary or to maintain its own local judicial system. Currently, the emirates of Sharjah, Ajman, Fujairah and Umm Al Quwain follow the federal judicial system, and Abu Dhabi, Dubai and Ras Al Khaimah maintain their own independent local courts. The local courts adopt civil law, conduct proceedings entirely in Arabic, and require the use of locally qualified lawyers. The tiers of local courts in the onshore UAE are as follows:

- Court of First Instance;
- Court of Appeal; and
- Court of Cassation.

It is common practice for the local courts to appoint a construction expert, or panel of

experts, to assist the court in determining factual and technical issues arising in construction disputes.

Offshore UAE

Both the ADGM and the DIFC have their own common law court systems, in which proceedings are conducted in English. The judges in these courts are international, spanning several common law jurisdictions. The DIFC Courts also appoint several Emirati judges.

The tiers of courts in the DIFC are the Court of First Instance and Court of Appeal.

The DIFC Court of First Instance is comprised of four separate divisions, being the Civil & Commercial Division, Technology & Construction Division, Arbitration Division, and Digital Economy Court Division. Of particular relevance is the Technology and Construction Division, which is designed to provide a suitable venue for the litigation of construction disputes in the DIFC.

The structure of the ADGM Courts is relatively similar, comprising the Court of First Instance (made up of the civil division, employment division and small claims division) and the Court of Appeal.

10.2 Alternative Dispute Resolution

Arbitration is the most popular form of dispute resolution for construction disputes in the UAE. The relevant Arbitration in onshore UAE is Federal Law No. 6 of 2018 (the UAE Arbitration Law).

In the offshore context, arbitration may be governed by the DIFC Arbitration Law or the ADGM Arbitration Regulations, respectively, both of which are based on the UNCITRAL Model Law on International Commercial Arbitration.

There are several arbitral institutions with a physical presence in the UAE, including:

- the Dubai International Arbitration Centre (DIAC);
- the Abu Dhabi International Arbitration Centre (arbitrateAD);
- the Sharjah International Commercial Arbitration Centre (Tahkeem);
- the Saudi Centre for Commercial Arbitration (SCCA); and
- the International Chamber of Commerce (ICC).

Additionally, the London Court of International Arbitration (LCIA) remains a popular choice for resolution of construction disputes in the UAE.

Dispute Avoidance Boards, or DABs, see some use on particularly large construction projects, although are not commonplace in the UAE. Additionally, while there have been efforts to promote the use of mediation in the UAE, including through the enactment of Federal Law No. 6 of 2021 (the UAE Mediation Law), uptake has remained low, with most dispute resolution clauses in construction contracts continuing to omit any requirement for mediation.



Trends and Developments

Contributed by:

Neal Morris, Anne-Marie Friel, Stuart Barr and Nicholas Brown
Pinsent Masons

Pinsent Masons is a purpose-led professional services firm with over 2,000 partners and lawyers across 28 locations spanning Europe, the Middle East, Africa, Asia and Australia. Renowned for its innovation and commitment to diversity, the firm was named Most Innovative Law Firm in Europe for the third time at the Financial Times Innovative Lawyer Awards Europe

2023. With a 50-year legacy in construction, energy, and infrastructure projects and over 100 partners and almost 450 lawyers specialising in this area, Pinsent Masons represents 18 of the top 20 international contractors (ENR250), and collaborates with governments, sponsors, funders, and investors on iconic projects that set industry benchmarks.

Authors



Neal Morris is a Construction, Advisory and Disputes partner at Pinsent Masons, with over 30 years' experience advising construction companies on major disputes on large

infrastructure projects. He has been ranked Band 1 in Construction by Chambers and Partners for 20 years. Neal is former head of TeCSA's Adjudication Committee, is a published author and a speaker on construction law. He is an expert in dispute resolution and PFI, NEC and JCT contract-based disputes, including internationally. He led the development of the firm's Adjudication Decision Data Analytics tool and created its Procurement-to-CompletionTM advisory service to manage risk on live construction projects.



Anne-Marie Friel is a Projects partner at Pinsent Masons and a non-contentious construction specialist, advising clients in the UK and internationally on major developments. She is an expert

in collaborative contracting, NEC, contractual joint ventures, sustainability and digitalisation in construction. She has led complex renegotiations on the UK's most significant infrastructure programmes and lectures and publishes on key industry issues including collaboration, sustainability and digitalisation. Anne-Marie is strategic advisor to the UK's Digital Twin Hub and is a steering group member of the Net Zero Infrastructure Industry Coalition.

UK TRENDS AND DEVELOPMENTS

Contributed by: Neal Morris, Anne-Marie Friel, Stuart Barr and Nicholas Brown, **Pinsent Masons**



Stuart Barr is a Projects partner at Pinsent Masons and has over 20 years' experience in the infrastructure and energy sectors. He is co-lead of the global PPP market team. Stuart

acts for public authorities, sponsors, contractors and funders on a range of economic and social infrastructure as well as energy from waste and renewable energy projects in the UK and overseas. He leads on highly complex transactions across the UK and Ireland, and is recognised by peers and clients as a market leader. A large part of his practice is advising on PFI/PPP operational issues (including dispute resolution, settlement and expiry/handback).



Nicholas Brown is a Construction, Advisory and Disputes partner at Pinsent Masons and a multi-jurisdictional lawyer, commercial arbitrator and FIDIC-certified

adjudicator with over 26 years' experience in dispute resolution on infrastructure and energy projects in Asia Pacific, the Middle East, Africa, the UK, Central Europe and Australia. He has served as counsel and arbitrator or adjudicator for clients seeking the resolution of commercial disputes in diverse projects and transactions in many countries and sectors (eg, renewables, conventional energy, oil and gas, transportation and mining). Nicholas writes on construction law and international commercial arbitration and is visiting lecturer at London University.

Pinsent Masons

30 Crown Place
Earl Street
London
EC2A 4ES
UK

Tel: +44 020 7418 7000
Web: www.pinsentmasons.com



Pinsent Masons

The UK construction market is vitally important to the country's economy. The construction industry employs almost one in ten of the UK's workforce. The volume of construction work in the market has been falling, but can be expected to transition to growth once again in 2025 based on the following three factors:

- the stage of the economic – in particular the interest-rate – cycle;
- the political climate; and
- continuing advances in innovation and technology.

Economic and policy indicators suggest that interest rates should be falling by and during 2025 from roughly 18-year highs. Indicators include the drop in inflation in April to 2.3%, which was very close to the Bank of England's 2% target. As a result, the International Monetary Fund now forecasts that the UK Bank Base Rate will be down to 3.5% by the end of 2025.

Historically, such declines have tended to lead to an uptick in private-sector investment and expenditure. Construction is usually the first market to benefit from this recovery in economic sentiment and growth.

Then there is the General Election announced for the UK in July. If the opinion polls are correct, there is a high likelihood of a change in UK government. Generally, new governments bring an initial increase in expenditure. This could mean additional central government capital expenditure, looser purse strings for local authorities, and the touting of new planning laws and other changes to promote increased home building. Even if the polls are not correct, we would expect a fresh mandate for the existing government (and the forecast improved economic con-

ditions mentioned above) to result in higher construction spending in the UK in the near future.

Lastly, technological innovation in the UK construction market continues apace. New developments in modular construction and off-site manufacture, for example, are set to endure. In addition, AI and other technological developments will impact construction – both in terms of methods of delivery and the types of assets and technology within them that the industry is called upon to build.

Impact of These Factors on the UK Construction Market

We would highlight seven key developments in the UK market in the year ahead, as follows.

“Up-Tick” Risk

This possible upturn in workflows for construction in the UK would likely create “up-tick” risk, because higher workloads would follow at least two years of reduced workflows, hyper-inflation and supply-chain disruption. These factors have all hurt the balance sheets of much of the supply chain – including at main contractor, employer and even local-authority level. Experience shows that the taps cannot be suddenly turned on to cope with such an up-tick – or at least without unintended consequences. Construction companies suddenly inundated with additional work can find themselves over trading and short of cash or other vital resources to meet new demand. What are the practical effects of this risk likely to involve? First, past cycles have often shown an increased incidence of supply-chain insolvency. Second, this stage of the cycle often evidences an increase in construction disputes, particularly at the early stage of such an up-tick.

Innovation

Innovation in all sectors is being driven by technology, and in particular by advances in Artificial Intelligence, and this is the case with the UK construction sector, too. Many UK construction companies are actively exploring and investing in what such technology can give them in terms of competitive advantage. In practice, this means that these technologies will require new collaborative forms of contracting for their development and use. They will also need new drafting to address the fresh issues that such advances raise. As with many such changes, the short term at least could see them viewed as a disruptors with unintended consequences, driving an increase in new types of disputes that require equally innovative resolutions. As a law firm specialising in the construction market, Pinsent Masons is deploying its own AI solutions for delivering legal services to construction clients. This has included the development of Decision Data Analytics tools to afford clients a competitive edge.

Increased Use of ADR

The UK Construction industry has always been at the forefront of developments in ADR, and this should continue in 2025. The landmark Court of Appeal ruling in the *Churchill v Merthyr Tydfil CBC* case, in which the court ordered a reluctant litigant to mediate, will soon be followed by changes to court rules to make this more commonplace. This has already been followed in one of Pinsent Masons' own construction cases, and the UK's specialist construction court (the Technology and Construction Court, or TCC) will likely spearhead its use since it is based upon the expertise of that court's specialist judges and their recent personal experience, as senior practitioners, in how mediation often, in practice, "unlocks" even the most challenging construction law disputes.

Net Zero

The practical effect on the UK construction market of environmental law changes to achieve net zero will continue. The built environment is rightly seen as a key driver for change, and will thus remain central to the serious, practical reform required. This is the case notwithstanding certain policy announcements suggesting a slight slowing of the pace of such changes.

Private Finance Initiative (PFI)

While this is no longer the current delivery method of choice in the UK construction market, PFI, also known as public-private partnership (PPP), is increasingly being used globally. The UK remains a centre of expertise on PFI, called upon to advise upon such projects globally. In addition, the huge number of such projects that have been delivered via this route means that 2025 will continue to see many issues around their operation. This has been evident recently with landmark legal cases relating to PFI projects. For example, in the 2023 *Sheffield Teaching Hospital Foundation Trust v Hadfield Healthcare Partnerships Ltd & Ors* case, the UK High Court ordered the "special purpose vehicle" (SPV) to provide £2.6m as security for the costs of its claims against a contractor. In another PFI case, *Kajima Construction Europe (UK) Limited v Children's Ark Partnerships Ltd*, the UK Court held that the tiered dispute resolution provisions in the PFI contract were unenforceable by the courts because they were too vague and uncertain. The resolution of disputes in such PFI arrangements was addressed in a report recently by the Infrastructure and Projects Authority (IPA). This called for the creation of a unique and bespoke dispute resolution forum for these PFI disputes. Will that take off in 2025? Whilst the idea has merit, it may be harder to achieve with the many stakeholders involved in PFI.

What is very likely is that these PFI projects will continue to give rise to many multi-party, multi-tiered disputes, requiring specialist skills and expertise to resolve. As well as operational issues, many of these long-term projects are now entering “hand back” phase. This is where the long-term (for example 25-year) “concession” during which the asset (eg, a hospital, road, street-light provision) was financed, operated and maintained by the private sector comes to an end. The PFI arrangements contain complex provisions to value the asset to be transferred (or handed back) to the public sector and then wound down the private sector operation. As a result, PFI disputes will remain a feature of the UK market. This will also be another specialist area of construction law where the UK innovates and leads global developments.

Building Safety

The impact of the UK’s Building Safety Act 2022 will continue to be felt at all stages of the construction process, from initial design through to post-completion disputes. For example, that Act now gives an unprecedented 30-year retrospective limitation period for claims under its unique provisions. As a result, issues around the safety of the UK’s buildings can be expected to remain a driving feature of the UK construction market in 2025. While many issues around the combustibility of cladding to high rise, residential buildings may have been remedied, and even litigated, many other building-safety issues endure. The new legal framework from the Building Safety Act requires a fresh approach to design, procurement and construction of UK buildings, as is reflected in new forms of contract and bespoke drafting. The UK courts will remain at the forefront of this area also. For example, the first Building Safety Act claims for contribution against the cladding system manufacturers, and later in 2024 a leading (seven-judge panel)

Supreme Court case on building safety and the law of negligence – in the *URS v BDW* case – can be expected.

Internationalisation

Not only will the opportunities in the “up-tick” UK construction market attract leading global designers, contractors and specialist suppliers, but the UK construction’s legal market will also play an increasingly global role. There is already hard data evidence of this in the latest figures from the UK’s specialist construction court, the TCC. In the year in which it proudly celebrated its 150th anniversary, its latest user figures show an impressive 38% increase in the number of applications dealt with in 2022/2023. This is due to the continued prevalence of the choice of English law in many international contracts, given its recognised predictability and underlying fairness and reasonableness. This is also because, whilst many overseas jurisdictions have specialist commercial courts, the UK’s TCC is rightly recognised for its unique further degree of specialism in construction and technology cases. This trend is likely to continue – with the reliability, cost effectiveness and world leading reputation of the UK’s TCC bringing more international disputes to the UK for resolution.

While such internationalisation will not be confined to the UK Courts, more international arbitrations are likely to be seated in London. Notwithstanding the attempts of many global jurisdictions to establish themselves as centres for international arbitration, London will continue and grow as a seat of choice. This will be driven by the global recognition of the quality and “bench strength” of the world’s leading construction law firms, counsel, experts and arbitrators.

Conclusion

The aforementioned seven key developments will see their evolution in the UK construction market in the year ahead and in the trends observed on the UK construction's legal market. These will continue to lead the way globally in forms of contracting, innovation and dispute resolution. Exciting times ahead!

USA – NEVADA



Law and Practice

Contributed by:

Leon F Mead

Mead Law Group

Contents

1. General p.651

1.1 Governing Law p.651

1.2 Standard Contracts p.652

2. Parties p.652

2.1 The Employer p.652

2.2 The Contractor p.653

2.3 The Subcontractors p.653

2.4 The Financiers p.654

2.5 The Designer p.654

3. Works p.655

3.1 Scope p.655

3.2 Variations p.655

3.3 Design p.656

3.4 Construction p.657

3.5 Site p.657

3.6 Permits p.657

3.7 Maintenance p.658

3.8 Other Functions p.658

3.9 Tests p.658

3.10 Completion, Takeover and Delivery p.658

3.11 Defects and Defects Liability Period p.659

4. Price p.659

4.1 Contract Price p.659

4.2 Indexation p.660

4.3 Payment p.660

4.4 Invoicing p.661

5. Time p.661

5.1 Planning and Programme p.661

5.2 Delays p.662

5.3 Remedies in the Event of Delays p.662

5.4 Extension of Time p.662

5.5 Force Majeure p.663

5.6 Unforeseen Circumstances p.663

5.7 Disruption p.663

6. Liability p.663

- 6.1 Exclusion of Liability p.663
- 6.2 Wilful Misconduct and Gross Negligence p.664
- 6.3 Limitation of Liability p.664

7. Risk, Insurance and Securities p.665

- 7.1 Indemnities p.665
- 7.2 Guarantees p.666
- 7.3 Insurance p.666
- 7.4 Insolvency p.667
- 7.5 Risk Sharing p.667

8. Contract Administration and Claims p.667

- 8.1 Personnel p.667
- 8.2 Subcontracting p.667
- 8.3 Intellectual Property p.667

9. Remedies and Damages p.668

- 9.1 Remedies p.668
- 9.2 Restricting Remedies p.668
- 9.3 Sole Remedy Clauses p.668
- 9.4 Excluded Damages p.668
- 9.5 Retention and Suspension Rights p.669
- 9.6 Termination p.669

10. Dispute Resolution p.669

- 10.1 Regular Dispute Resolution p.669
- 10.2 Alternative Dispute Resolution p.669

Contributed by: Leon F Mead, Mead Law Group

Mead Law Group has been handling construction law matters almost exclusively for over 30 years. The firm is primarily devoted to representation of all construction industry groups in public and private construction-related matters. These include, but are not limited to, contracts, preparation, litigation, arbitration and mediation, licensing, and construction-related administrative issues. Dedicated to development of Nevada laws that impact construction, Mead Law Group's attorneys advise their clients and

industry partners on the extensive and unique laws affecting the Nevada construction industry. They have also provided testimony before numerous state legislative committees on construction-related topics and expert analysis on Nevada construction legal issues, and often conduct seminars for construction industry groups. Mead Law Group provides its clients with AmLaw 200 quality legal counsel with a small law firm approach to customer service and client connection.

Authors



Leon F Mead is managing partner of Mead Law Group and is now in his 34th year of construction law practice. Leon has dedicated his entire career to the issues focused on the construction industry in the United States, and specifically for the states of California and Nevada. His work is recognised by his 2006-2023 Band 1, Litigation: Construction-Nevada ranking by Chambers USA.

Mead Law Group LLP

7251 W Lake Mead Blvd
Suite 460
Las Vegas, Nevada 89128
USA

Tel: +44 702 745 4800
Fax: +44 702 745 4805
Email: admin@meadlawgroup.com
Web: www.meadlawgroup.com



1. General

1.1 Governing Law

The state of Nevada structures its law in the traditional method used in the United States, with a set of statutory codes enacted by the legislative process and approved by the executive or Governor. The statutory codes are known as the Nevada Revised Statutes (NRS) and are set out in chapters with sections identified by numeric index. The NRS can be accessed through the Nevada Legislative Counsel Bureau, at this [website](#). Of particular interest to the construction industry are the following chapters:

- Chapter 38: Mediation and Arbitration;
- Chapter 40: Constructional Defects;
- Chapters 104 & 104A: Uniform Commercial Code;
- Chapter 108: Mechanics Liens;
- Chapter 338: Public Works;
- Chapter 339: Contractors Bonds on Public Works;
- Chapter 341: State Public Works Division;
- Chapter 408: Highways, Roads and Transportation Facilities;
- Chapters 439 through 461A: Statutes related to Public Health and Safety of specific industries;
- Chapters 512 through 522: Statutes relating to Mining Activities;
- Chapters 606 through 618: Statutes related to Labor, Employment and Industrial Relations;
- Chapter 623: Architects, Interior Designers and Residential Designers;
- Chapter 623A: Landscape Architects;
- Chapter 624: Contractors;
- Chapter 625: Professional Engineers and Land Surveyors;
- Chapter 627: Construction Controls;
- Chapters 702 through 712: Energy, Public Utilities and Similar Entities.

These legislative enactments create a number of bureaucracy departments which manage different aspects of industry in the State. Most of these departments promulgate regulations and rules that govern their processes and procedures. These regulations are found in the Nevada Administrative Code, and are provided the same impact and effect as statutory provisions of the NRS by Nevada courts. The Nevada Administrative Code (NAC) can be located at this [website](#). Generally, regulations issued by specific bureaucracies will have corresponding chapter numbers that match the establishing chapter from the NRC. For instance, NAC Chapter 624 sets forth regulations governing contractors as well as the Nevada State Contractors Board established and governed by NRS Chapter 624.

In addition, each municipal jurisdiction will adopt specific standardised building code requirements that will also impact construction projects in the State. These should also be considered when applicable.

Nevada courts are established in Judicial Districts, which can preside over issues and disputes in one or more Nevada counties. The courts within each Judicial District are divided based on dispute dollar values or specific and unique dispute contexts. Generally, disputes under USD15,000 will be handled by Justice Courts within a Judicial District. Larger disputes of over USD15,000 are heard by District Courts, who also hear appeals from Justice Court decisions. District Court decisions are appealed to the Nevada Supreme Court, but can be referred to the Nevada Court of Appeals for certain specific disputes or matters considered less impactful on the State law as a whole. Decisions by the Nevada Supreme Court and the Nevada Court of Appeals designated for publication are

published in the Nevada Reports, which can be accessed [here](#).

1.2 Standard Contracts

Nevada does not promulgate an official set of “standardised” contracts for any purpose. However, standard “form” contracts are issued by various construction industry groups and are routinely used and modified by the parties for specific project purposes. In general, Nevada will enforce arms-length negotiated agreements, especially between businesses generally considered to be more sophisticated than consumers or the general public. Standard form contracts issued by the Architectural Institute of America (AIA) and “ConsensusDocs” issued by the “ConsensusDocs Coalition” are the most common types of standardised construction documents used in Nevada.

2. Parties

2.1 The Employer

Nevada construction projects can be started by both private persons or entities and public entities within their jurisdictions (or both). Since large portions of land in Nevada are still owned by the United States Federal Government, the United States government and its myriad bureaucracies, departments and divisions also issue construction contracts.

The essential obligations for the Owner are to provide entitlement to construct the work through jurisdictional authorities (ie, property rights), a completed design, and the funds necessary for the work of improvement to be constructed on a timely basis. Additional obligations may exist as a result of negotiations between the contractor and the owner during the pre-construction process and the selected delivery

method. While this description of the Owner’s essential obligations is over-simplistic, omitting myriad details, the responsibilities of an Owner on a construction project will generally fall within these categories.

In exchange for providing these things, the Owner has the right to expect its contractor(s) to complete the work on a timely basis and in accordance with the contract document requirements. In most instances, these include the plans and specifications, code compliance obligations, the project schedule, specific performance issues, etc.

The Owner has an obligation to make timely payment and to secure sufficient funding for the project costs. Nevada law provides contractors with strong rights to payment, including a right to a Mechanic’s Lien which encumbers the work of improvement and affected land used therefor to secure payment for the work performed. If the Owner does not make timely payment, the contractor, subcontractors, and others providing labour, materials, equipment, and services for the work of improvement have the right to place and foreclose upon a lien to secure payment. These liens generally have priority over the Owner’s interest in the work of improvement and the land, and may have priorities over the project lenders under certain circumstances.

In most instances, the Owner will hold a direct contract with the general contractor for the construction project and will provide the contractor with plans obtained from a separate design firm. Depending on the delivery method chosen, however, the general contractor may have more defined pre-construction and/or design roles. In such cases, the general contractor may be referred to as a Construction Manager at Risk (CMAR), Construction Manager as Agent

(CMAA), or a Design/Builder. In all cases, including a typical arrangement with no defined pre-construction or design role, with the exception of a CMAA, the general contractor entity will hold and manage the subcontracts with first tier subcontractors and suppliers.

2.2 The Contractor

Contractors in Nevada must be licensed by the Nevada State Contractors License Board (NSCB), having demonstrated sufficient competence and financial strength to perform construction projects of various types and cost. Nevada provides three types of contractor licence classifications, as follows:

- A – General Engineering Contractor;
- B- General Building Contractor; and
- C – Trade Contractor of Specific Types.

Each of these general categories has numerous subclassifications that allow for the construction of a subset of the types of work performed.

Type A licence holders, General Engineering Contractors, are permitted to perform construction of projects that generally required more specific engineering expertise, such as roads, bridges, airports, dams, electrical power plants and transmission lines, water treatment plants, and similarly related infrastructure.

Type B licence holders, General Building Contractors, are permitted to perform construction projects that are intended for human or animal housing and function, such as office buildings, residential buildings, recreation facilities, etc.

Type C licences, Trade Contractors, are reserved for those contractors who perform specific specialised trade work, such as plumbing, framing,

steel erection, electrical installation, heating ventilation and air conditioning, etc.

A contractor can also hold a Class “AB” licence, which allows them to build any type of project, regardless of its specific function. Nevada also imposes a financial “bid limit” on all contractors, which limits the maximum value of a construction project they are lawfully able to perform. This is intended to ensure that no contractor undertakes a construction project that is beyond their corporate financial strength and ability to complete successfully. A contractor can be granted an “unlimited” licence if they can demonstrate the ability to financially handle a project in excess of USD10 million.

In the most typical construction project, the general contractor will hold the sole general or prime contract with the Owner, and will in turn hold numerous subcontracts with second-tier subcontractors and suppliers. In this case, the general contractor acts as the “manager” of the project, handling the daily workflow, sequence and schedule of the subcontractors performance, coordination with the jurisdictional authorities, and interactions with the Owner and design professionals to ensure the work in the field meets the design intent expressed in the contract documents.

2.3 The Subcontractors

As noted above, subcontractors fall into various categories of work performance or “trades”. There are 42 separate Class C trade licence subclassifications, including a “catch-all” classification for work that does not specifically fit into another classification but requires specialised skill as determined by the NSCB. To obtain such a licence, the subcontractor must pass examinations designed to test their competency on the specific trade work of each subclassifica-

tion, as well as knowledge of legal and management obligations imposed under Nevada law. As with general contractors, Class C trade contractors also are provided a “bid limit” that restricts the maximum value of their contracts to ensure financial viability.

Subcontractors will, in most cases, hold a direct subcontract with the Project general contractor, and will, in turn, hold sub-subcontracts with lower-tier subcontractors and material and/or equipment suppliers. The subcontractors will be responsible for managing their own work, as well as the work of their sub-subcontractors, and for ensuring their suppliers’ timely and accurate supply of appropriate materials for the work of improvement to achieve the design intent of the construction documents. Subcontractors are responsible for timely and accurately performing their designated portions of the work, ie, that it meets code requirements and the design. They will be responsible for reworking any portions of their work rejected by the jurisdictional authority or the design professionals should the work not meet code requirements or design intent. Subcontractors can also be responsible for any portions of the project that they “design-build” (ie, HVAC systems, pools, etc).

2.4 The Financiers

In most privately owned construction projects, the work is financed through some form of construction loans. Larger project owners can self-finance the work if they chose, but, typically, unless owned by government entities, larger projects will be backed by construction loans. Depending on the nature of the project, these loans can take the form of corporate or public bonds, but, in most cases, a specific lending institution, bank, or other private lender will provide the bulk of the project funding and receive a reciprocal interest in the property from

the owner, along with the promise of repayment with interest. This security interest in the project property is typically in the form of a deed of trust or mortgage.

Depending on the type of loan, the lender may not be involved in the construction process whatsoever, or may be actively involved by periodic inspection of the work and control of payment distributions to the contractor(s). The degree of involvement will be dictated by the construction loan agreement and the construction contract. Companion agreements providing work-continuation guarantees, performance bonds, indemnity or other commitments from the general contractor and key subcontractors for the benefit of the construction lender can be required as part of the construction loan package.

The lender may also require other types of protection from claims for payment and mechanics liens, mentioned above. In Nevada, these may take the form of restrictions against construction commencement prior to recordation of all construction loan documentation, payment bonds, title verifications before release of progress payments, draw inspections, payment-application certifications, project-completion cost projections, and schedule updates as the work proceeds, to ensure the work of improvement will be completed on time and on budget as the project progresses.

2.5 The Designer

The design professionals for the typical construction project are usually retained by the Owner, and consist of a lead Architect and sub-consultants, including engineering and other design professionals of specialised disciplines. These professionals are also licensed through Nevada state agencies responsible for governing

the specific professional regulations, education and competency requirements. The Architect will usually lead the design team and be responsible for implementing the Owner's project programme requirements, overall design concept, and coordination of the design and instruments of service, interaction with jurisdictional authorities for design review, revision, code compliance, and permit approval. Typical engineering disciplines will include site/civil, structural, electrical, plumbing and wet utilities, mechanical, and fire/life safety systems. Depending on the Project, other engineers and consultants may be included to meet specific code or governmental mandates, such as access for disabled persons, beverage-delivery systems, kitchen, power plant, exiting, traffic, and other parts of the Work that require unique design.

The design team will directly contract with the Owner in most cases and, after completion of the design documents, will perform certain construction phase services for the Owner as part of the Owner's obligations under the construction contract. These may include periodic inspections of the work to confirm conformity with design intent, preparation of responses to the contractor's requests for information intended to clarify the design instruments of service, making decisions on minor disputes between the Owner and Contractor, and/or similar services.

Design professionals are also entitled to payment security by way of mechanics lien in Nevada. They also typically retain ownership in their design work as intellectual property and are not able to transfer ownership rights to the Owner or any other third party. Instead, they provide a license right for use the intellectual property to the project owner by operation of contract.

3. Works

3.1 Scope

The scope of a work of improvement in Nevada is a negotiated process involving the design created by the design team, implementing the Owner's project programme or "vision" for the Project. It is the design team's responsibility to achieve the Owner's vision of the Project's appearance, performance, operation and ongoing maintenance. The design, once finally approved by the jurisdictional authorities, will consist of various "instruments of service", including dimensional plans, drawings, schematics and instructional text in the form of design notes and specification books. Depending on the specific type of project and its intended use, these documents may have different titles and abbreviations.

Typical construction contracts will specifically include the entire design instruments of service and expandatory language to ensure that omissions from design that are necessary to achieve design intent are included in the general contractor's scope of work. This can be a source of dispute in the negotiation process, as well as in the construction phase when the scope of work contract provisions is not well prepared. These disputes will usually arise in the form of change orders to the construction contract.

3.2 Variations

"Variations" or "changes" come in several forms. Depending on the contract language, they can be referred to by various names, including "Change Order", "Request for Change Order", "Change Order Request", "Construction Change Directive", "Architect Special Instructions", "Owner Requested Change", "Contractor Requested Change," "Modification", or other nomenclature (and their abbreviations) that at times seems as unique as the project. Regardless of the chosen

term for such variations, they seek (or create) a revision of the contractual terms in some fashion. Depending on their scope and cost, they can and will affect both the actual work performed by the contractor and the price the contractor will be paid to complete the work as changed.

Change Orders will usually be categorised according to the party requesting the change and the reason for which the change is necessary. In general, changes are made to the design (whether required by the Owner or driven by involvement of the jurisdictional authority, or inaccurate/incomplete design), or to field conditions. Sometimes, such changes, or other circumstances, can cause delays or impacts to the work progress. Such delays or impacts are usually addressed by a claim submitted first by the contractor in the form of a change order request, seeking time, additional funds, or both. The failure to approve a contractor-originated change order request will result in a disputed “claim”. Most construction disputes and litigation arise over disputed change orders in one form or another.

In Nevada, a unique set of statutes, referred to as the Nevada Prompt Payment Act (NPPA) (NRS 624.606 through 624.630, inclusive), covers statutory provisions regarding the approval of change order requests submitted by contractors. In general, the statute provides that submission of a change order request to the owner by the general contractor (or by a lower-tiered subcontractor to a higher-tiered contractor with whom they have privity of contract), triggers a 30-day period in which the owner or higher-tiered contractor must affirmatively accept or reject the change order request in writing. Failure to reject the change order in writing within 30 days of receipt will make the requested change order part of the contract by operation of law

– the contractor will be entitled to enforcement of the terms of the change order request as if it were agreed to by all parties. Therefore, when completing a construction project in Nevada, owners and higher-tiered contractors must be diligent to address change order requests on a timely basis on private, non-residential projects.

Residential projects (owned by occupiers of the residence upon which construction is being performed) are not subject to the provisions of the NPPA, including the aforementioned change request provision. Nevada has distinct statutes governing such projects, which provide additional protections to the owner-occupier of a residential project, including requirements that change order requests be signed by the owner-occupier to be enforced, among other things.

3.3 Design

As noted above, design for a construction project is divided among professionally licensed design disciplines, such as engineers and architects. Except for licensed contractors who intend to construct their own designs, only professionally licensed design professionals may provide project design intended for construction permitting. The owner’s obligations are limited to conceptual ideas and operational requirements, which the design professionals must implement through their instruments of service.

Contractors may contribute to the design process by providing preconstruction services (such as preliminary cost estimates and value engineering) or, in unique disciplines (such as fire/life safety), will provide their own designs for inclusion in the design instruments of service. As noted above, there can be numerous consultants providing design input, but design teams most typically include individuals or firms specialising in Architectural, Site/Civil, Plumb-

ing, Electrical, Mechanical, and Fire/Life Safety disciplines.

3.4 Construction

As noted above, construction is divided between the general contractor and multiple trade subcontractors that hold the requisite licences to perform the various parts of the construction process necessary to achieve design intent. If construction of a design requires more than two unrelated trade subcontractors to complete, a general contractor must be hired by the owner to complete the construction. Importantly, while a general contractor can perform most trade-specific work on a construction project, they may only self-perform plumbing, electrical, refrigeration, or life safety work if they hold the specific Type C trade licence for that discipline in addition to their Type A or Type B licence. Otherwise, the general contractor must hire a trade contractor holding the Type C licence required to perform those portions of the construction.

3.5 Site

The general contractor is typically responsible for the construction site, throughout the course of construction. This responsibility is imposed both by contractual provisions and regulations imposed on the party who “pulls” the construction permit for the project. This responsibility includes all aspects of the site that exist and are unknown (geotechnical conditions, archaeological finds, underground obstacles, etc), as well as those imposed through the course of construction, such as pollution, site safety, vandalism, etc. However, provisions are often included in construction contracts to transfer this risk back to the Owner when such site-related issues are found.

In general, however, if there is no specific contractual provision governing discovery of an

unknown site condition, the party charged with responsibility depends on the type of condition found. In Type 1, differing site condition cases, the site conditions are unknown to exist on the particular construction site at the time the construction contract is executed but are (or should be) expected by contractors with experience in the local area. In Type 2, differing site conditions cases, the site conditions are both unknown and unexpected by contractors with experience in the local area. Typically, resolution of Type 1 conditions is the responsibility of the contractor and resolution of Type 2 conditions is the responsibility of the owner. However, if the contractor endeavours to resolve a Type 2 condition without providing notice to the owner of the condition and without requesting direction for resolution, the contractor can be held responsible for the resolution. In the case of archaeological finds, grave sites, endangered species and other types of conditions, federal and/or state law may apply and provide specific methods of resolution for such site conditions to avoid liability.

3.6 Permits

Whether or not a specific work of improvement, or a specific part of a larger work of improvement, requires the issuance of a construction permit is a matter of local code and ordinance. The need for a permit or the lack of a need for a permit can be surprising. For instance, in some Nevada jurisdictions, replacing an existing water heater with a new one requires a permit, but the pouring of a concrete driveway will not. Whether a specific project needs a permit, however, must be determined and addressed before work commences to avoid adverse action by jurisdictional authorities.

The general contractor will be responsible for pulling the permit if one is needed. The design professional team is responsible for applying for

permits and obtaining approval of the permit, so work can commence after the contractor receives it and accepts responsibility for compliance with its requirements. After a general construction permit is obtained, specific subcontract disciplinary permits may also be required. These can come from other governmental agencies than the jurisdictional building departments, such as the fire department, the health district, etc, depending on the Project use. The general contractor is expected to coordinate all required permits for the work.

3.7 Maintenance

Except in unusual circumstances, once a construction project achieves completion it is turned over to the Owner for use and occupancy. All maintenance of the facility will revert to the Owner and the contractor is released from continued maintenance beyond its contractual obligations. In limited cases, statutory obligations can require the contractor to guarantee performance of their workmanship for certain periods of limitation, but such obligations do not extend to ordinary maintenance required for the work, or normal issues caused by expected occupancy wear and tear. Any obligation to provide such ordinary use maintenance is a contractual obligation beyond the typical construction contract.

3.8 Other Functions

Other functions between the owner and the contractor are not typical, and would be considered only in specific contractual circumstances, governed by the kind of project and the needs of the Owner.

3.9 Tests

Testing of systems and operations of the work of improvement are handled by the general contractor and specific disciplinary subcontractors, with applicable jurisdictional authority inspec-

tors. These tests and confirmations must be passed to obtain permission to complete follow-up work, or final certificates of occupancy or certificates of completion for continuance of construction when necessary for the Project's occupancy and use. Failure to pass such tests will require that the work be stopped or will prevent use of the project until repairs are made.

3.10 Completion, Takeover and Delivery

In most cases, Nevada will follow a typical process of completion that begins after substantial completion is achieved. Substantial completion can be specifically defined by contract, but generally it is understood to be when a project is sufficiently complete that the owner may use it for its intended purpose, even if there remains construction work to complete. Substantial completion can be accompanied by the issuance of a temporary certificate of occupancy, which allows the owner to begin certain functions of takeover while final inspection and testing is being completed by the contractor.

Usually, when a contractor believes they have achieved substantial completion of the Project, there is a job walk performed to create a "punch list" of remaining issues that must be completed by the contractor before the architect and/or the owner will accept the project as complete. Once this punch list is agreed upon, the contractor completes the punch list within a specified period. Payment of contractually withheld retention can be made after substantial completion is achieved, but, in most cases, will not be released in total until final completion and acceptance has occurred. Specific requirements to achieve final completion are set out in the contractual agreement.

3.11 Defects and Defects Liability Period

Pursuant to the provisions of NRS 11.202, the statute of limitations for injuries caused by deficiency in the design or construction of a work of improvement is 10 years after substantial completion of that work of improvement, which is uniquely defined. In general, if the work has not achieved substantial completion as defined for this purpose, a claim for construction defect cannot arise, but would be actionable by either breach of contract or negligence. In a residential structure, as opposed to a commercial structure, a claim for construction defect is handled through unique statutory provisions found in NRS 40.600 through 40.770, inclusive. Such provisions and details are beyond the scope of this guide, but unique remedies and procedures (as well as indemnity and insurance requirements) are available to residential homeowners within these provisions that do not apply to commercial project owners. Commercial project owners are limited to claims arising from their contracts and provisions therein, with the courts generally finding that such contracts are better suited to distribute risks of deficient construction and the results thereof.

4. Price

4.1 Contract Price

Payment methods and methods for determining the contract price vary greatly in Nevada. Smaller construction projects are delivered usually on lump sum or fixed price amounts, based on an estimate against a completed design. This “Design-Bid-Build” delivery method relies on a completed and coordinated design, and competent estimating system. Most public works projects are competitively bid using this method. In the private works sector, this method is also often used, followed by a session of negotia-

tions with the leading general contractor over the final contract price. Such negotiations are not allowed in the public works context on competitively bid projects.

The next most commonly used process in private works construction is the use of a cost of the work plus a fee, usually accompanied by a guaranteed maximum price that the Contractor will not exceed, absent approved change orders. This “Cost Plus with a GMP” delivery method also often will include preconstruction services by the selected contractor (here called a “Construction Manager at Risk” (CMAR)) during the construction document preparation stage of design. The fee is the percentage markup the CMAR negotiates to add to the actual cost of the work incurred during the construction process. Through the course of the preconstruction phase, the contractor estimates the maximum cost the completed design. Once the contract is signed, the contractor expects the completed design to conform to that stated design intent, so it can keep construction costs within the GMP maximum price. Often, incentives such as shared-savings clauses are used to incentivise the general contractor to stay below the GMP. If design changes cause the GMP to be exceeded, the general contractor will seek a change order to increase that GMP amount.

Sometimes, contractors will use a variation on the Cost-Plus concept without a GMP. This is also known as “Time and Material” or T&M. In this method, the general contractor prices the construction work on the actual cost of material and the actual cost of labour over the amount of time the work takes, and then adds a mark-up for overhead and profit. Many change orders are performed based on this principle.

4.2 Indexation

Indexation or price fluctuations occur when commodity prices impact the cost of raw materials, such as copper, lumber, fuel, and even labour. These fluctuations can have substantial impacts on contractors performing contracts on a lump-sum basis, or contracts with a guaranteed maximum price. If price fluctuations are a concern, construction contracts are drafted with price-escalation provisions that link commodity-based materials to specific time indexes that allow for increases at certain levels should raw materials costs increase or decrease. Alternatively, owners may fund larger purchases of materials at earlier times to avoid such fluctuations. Such circumstances are routinely handled through contract negotiation phases, and are not routinely addressed by statute or regulation, except for specific public works projects such as transportation projects with long-term schedules for completion.

4.3 Payment

Like almost all aspects of Nevada construction, the rights and responsibilities for payment are governed by the construction contract terms. Payments and the components of a completed payment application are governed by the contract terms and the lender (if any) requirements for progress draw release. Because of the aspect of mechanics lien claims, statutory Mechanic's Lien payment waiver and release forms are specified to induce payment at certain intervals. These waiver and release forms are found at NRS 108.2457(5), and come in four specific forms for specific purposes, as follows:

- Conditional Waiver and Release upon Progress Payment;
- Unconditional Waiver and Release upon Progress Payment;

- Conditional Waiver and Release upon Final Payment; and
- Unconditional Waiver and Release upon Final Payment.

All of these release forms, however, are conditioned on receipt of payment specified, regardless of their language. See NRS 108.2457(2) and cf. NRS 108.2457(5)(e).

The NPPA, discussed in 3.2 Variations, also impacts payment on construction projects. In addition to the impacts previously covered regarding variations and change orders, the NPPA also governs when payment must be made and what remedies are available to a contractor in the event of non-payment. Generally, the NPPA requires payment to be made on or before the date that payment is specified to be due in written contract. When no written schedule of payments exists in a written contract, an owner must make payment to a general contractor within 21 days of presenting an invoice. A subcontractor must be paid within 30 days of its presenting an invoice to a higher-tiered contractor. The owner or higher-tier contractor must either pay the invoice by the date specified in the contract or statute or provide written notice of intent to withhold funds. Funds may only be held for certain reasons and in certain amounts.

If the notice of withholding is not provided and payment is not made on a timely basis, the contractor expecting payment may stop work on the project, after giving written notice of its intention to do so. If payment is still not made after the contractor stops work, the contractor may provide additional written notice of its intention to terminate the contract, and then do so. Upon such termination, the contractor may seek to recover what payment is actually due under

its contract, plus reasonably incurred attorneys' fees and costs.

General contractors often include pay-when-paid or pay-if-paid clauses in their subcontracts with lower-tiered contractors, to avoid responsibility for payment to their subcontractors before they have been paid by the owner for the subcontractor's work. The NPPA arguably supports the enforceability of a pay-if-paid and/or pay-when-paid contractual provision. Case law interpreting the NPPA, however, has not been clear about when and under what circumstances such contract clauses may be enforced.

Final payments, in the form of released withheld retention, are received after actual completion and provision of all turnover requirements.

4.4 Invoicing

Somewhat related to the discussion of payments in 4.3 **Payment**, invoicing is an issue reserved in contractual terms between the contracting parties. There is no express or standardised form for invoicing or payment applications, and each project is different. Actual forms provided by various standardised form services, such as the AIA Contract forms, are often used in lieu of party generated forms. Construction project lenders sometimes require specific forms, such as the AIA forms, which include certifications by the invoicing party of the accuracy of the construction progress described in the invoice.

Invoices are accompanied by Conditional/Unconditional waiver and release forms also discussed in 4.3 **Payment**. Specific contractor requirements beyond these are contractually generated and must be reviewed to ensure compliance.

5. Time

5.1 Planning and Programme

The planning, sequencing, and scheduling of the various activities making up a construction schedule are handled by the General Contractor on the Project. As with most United States jurisdictions, a general contractor is responsible for the means and methods of putting together a given construction project, and the project Owner is prohibited from interfering with those means and methods. An owner's interference with the construction scheduling can lead to claims for delay, disruption, constructive acceleration and/or other impacts, or, in extreme cases, claims of owner abandonment of the entire construction project contract.

Construction scheduling is a matter of theoretical concept in many respects, and there are different methods for doing so, with computer programmes to assist readily available. The most commonly used method in commercial construction is the critical path method schedule (CPM), where the sequence of activities is linked by computer code in a logical sequence, beginning from preconstruction activities through final inspections and close-out. The longest sequence of activities provides the project's "critical path", and time-based claims are evaluated against that critical path and impacts thereon. Such scheduling is preferred by most courts in the United States when evaluating time-based claims for damages arising from construction projects. However, the use of alternative methods does not preclude such claims.

Smaller projects can use bar graphs, or even calendars written by hand. Regardless, the sequence of the activities is set out in a natural sequence that allows for the timely completion of activities necessarily predecessors to later

activities, which are predecessor to still later activities and so forth, through completion.

Critical path scheduling is not the exclusive basis for scheduling a project and simply contractual scheduling can be enforced successfully.

5.2 Delays

The occurrence of delays does not always result in a claim. For instance, construction-project schedules created by CPM naturally have a certain amount of extra time (referred to as “float”) around most activities. “Float” in this instance is thought of as a time commodity on a construction project, which can be used by any party who needs it until that particular activity becomes “critical” – that is, becomes the next activity in the longest sequence of activities that must be performed to deliver the project on schedule. Once an activity becomes “critical”, the party causing delay to the activity incurs liability for the delay, unless an exception exists.

Exceptions for delay liability are generally found in the causal source of the delay, or the fact that other critical activities are simultaneously impacting the critical path, and thereby excuse delaying activities that are concurrent.

Calculation of time-based damages are best understood as additional costs for the time expended unnecessarily during the delay, as well as inefficiencies in productivity. Additional costs can be in categories of lost revenue or additional expenses in the case of an owner, or in the case of a contractor’s additional expenses in general conditions, increased material costs and inefficient labour productivities.

Delays and their cause are an issue of theoretical science in many cases, usually falling within the parlance of expert testimony and analysis, which

is therefore required in most cases through the litigation process. The type of analysis used to calculate delays and resulting claims is dependent upon the type of scheduling method used during the construction project. The analysis is also affected by relevant contract provisions.

5.3 Remedies in the Event of Delays

Remedies for delay often depend on contractual waivers or limitations, occasionally impacted by statutory prohibitions on such clauses. In Nevada, a “no damage for delay” clause is limited by application of NRS 108.2453 provisions to circumstances that are contemplated by the parties, that are reasonable under the circumstances to the contractor, or for which the contractor is responsible. So long as the rights conferred to a contractor under NRS Chapter 108 are not affected, Nevada courts enforce “no damage for delay” clauses. See, for example, *J.A. Jones Constr. Co. v Lehrer McGovern Bovis, Inc.*, 120 Nev. 277, 285 (2004).

On the owner’s side, it is routine for consequential damages arising from delay to be waived. Such damages are usually lost revenue, lost use, increased financing costs, and so on.

5.4 Extension of Time

Time extensions are usually driven by some other event that may cause the work to be delayed or cost more than contemplated – eg, an owner change of design, or an unforeseen condition or impact. In most cases, the request for additional time will be included in a change order request and supported by a time impact analysis. In CPM scheduling, time impact analyses may require compartmentalised fragment-of-schedule sequencing analysis, or “fragnet”, that shows how a particular event impacts the overall schedule critical path. Once again, in most CPM cases, the availability of project “float” and the

determination of liability for the extension cause will need to be analysed by expert testimony.

5.5 Force Majeure

Nevada has no mandatory or statutory prohibition of waiver or enforcement other than as contractually specified or restricted under the same provisions impacting delay claims. A force majeure clause will be enforced as written in the State and will be limited to its listed circumstances.

5.6 Unforeseen Circumstances

In general, unforeseen circumstances giving rise to impacts are not protected for an owner's interests. As noted, NRS 108.2453(2)(e) provides protection to a contractor who incurs damages for time and money from events that were "not contemplated by the parties" at the time of contracting. As such, contractual provisions shifting risk of such actions to the contractor or waiving rights for unforeseen conditions are potentially void and unenforceable.

5.7 Disruption

Disruption to the contractor's planned means and methods of construction or schedule can be a cause of recoverable damage, if such disruptions are caused by circumstances outside the control of the contractor, and, in most cases, impact the critical path of the construction schedule. Damages for such disruptions would be measured based on time extensions to the construction sequence, as well as the increased costs to the construction and lost productivity caused by the disruptive events and impacts.

6. Liability

6.1 Exclusion of Liability

Within the context of construction, the non-waivable liabilities are fairly limited in Nevada. Certain types of waivers are restricted as violative of public policy, and primarily surround purported contractual waivers of obligations and liabilities imposed on contractors that limit their options to recovery payment for their work.

NRS 108.2453 provides certain limitations on waivers of rights within a construction contract that relate to the Mechanic's Lien. Specifically, under subsection 1, "a person may not waive or modify a right, obligation or liability" that is provided under the Nevada Mechanic's Lien (NRS 108.221 through 108.246, inclusive). As such, except as specifically addressed in NRS 108.2457, the Mechanic's Lien provisions may not be waived or limited and the owner's obligations under those provisions may not be waived or modified. In addition, specific provisions are prohibited under NRS 108.2453(2), which include the following:

- requiring a lien claimant to waive or limit rights afforded lien claimants;
- relieving a person from obligations or liabilities under the Nevada Lien law;
- making a Nevada construction contract subject to the laws of another state;
- requiring venue for dispute resolution on a Nevada located project to occur in another state, and
- requiring a contractor to enter into a waiver of delay or other impact damages under certain circumstances.

Additionally, under the NPPA, contractual provisions that waive or limit the rights of lien claimants to receive the benefits, or relieve the owner

or higher tiered contractors from obligations and liabilities under the NPPA, are also void and unenforceable as against public policy. See NRS 624.622(2), and *cf.* NRS 624.628(3).

6.2 Wilful Misconduct and Gross Negligence

No Nevada case law or statutory prohibitions forbid or allow the exclusion or limited liability for gross negligence or wilful misconduct in the context of a contractor in the act of construction. However, based on various decisions and comments of the Court, it could be surmised that Nevada courts would not accept an exclusion of liability for a person's own wilful misconduct.

Neither wilful misconduct nor gross negligence is statutorily defined in relation to the public, but the concepts are recognised by statute and carry different and specific consequences when so raised. Under case law, the Court provides some definition and recognises a distinction between "ordinary negligence" and "gross negligence" as an issue of degree, and distinguishes both from "wilful misconduct." As it stated in 1979:

"This court has consistently distinguished the concepts of ordinary or gross negligence from the concepts of willful or wanton misconduct. Gross negligence is manifestly a smaller amount of watchfulness and circumspection than the circumstances require of a prudent man. But it falls short of being such reckless disregard of probable consequences as is equivalent to a [willful] and intentional wrong. Ordinary and gross negligence differ in degree of inattention, while both differ in kind from [willful] and intentional conduct which is or ought to be known to have a tendency to injury."

Davies v Butler, 95 Nev. 763, 771, 602 P.2d 605, 610 (1979) (citing *Hart v Kline*, 61 Nev. 96, 101,

116 P.2d 672, 674 (1941)). In *Hart*, the Court adopted a definition of gross negligence from another jurisdiction:

"Gross negligence is substantially and appreciably higher in magnitude and more culpable than ordinary negligence. Gross negligence is equivalent to the failure to exercise even a slight degree of care. It is materially more want of care than constitutes simple inadvertence. It is an act or omission respecting legal duty of an aggravated character as distinguished from a mere failure to exercise ordinary care. It is very great negligence, or the absence of slight diligence, or the want of even scant care. It amounts to indifference to present legal duty, and to utter forgetfulness of legal obligations so far as other persons may be affected. It is a heedless and palpable violation of legal duty respecting the rights of others. The element of culpability which characterizes all negligence is, in gross negligence, magnified to a higher degree as compared with that present in ordinary negligence. Gross negligence is manifestly a smaller amount of watchfulness and circumspection than the circumstances require of a prudent man. But it falls short of being such reckless disregard of probable consequences as is equivalent to a willful and intentional wrong. Ordinary and gross negligence differ in degree of inattention, while both differ in kind from willful and intentional conduct which is or ought to be known to have a tendency to injure."

Hart v Kline, 61 Nev. 96, 116 P.2d 672, 674 (1941) (citations omitted).

6.3 Limitation of Liability

As previously discussed, Nevada will, where there are no public policy prohibitions, enforce most contractual provisions between corporate actors. Contractual provisions with consumers can be subject to arguments of adhesive

or unconscionable contractual provisions and unequal bargaining power. There are no specific cases or statutes prohibiting a limitation of liability within the context of construction between commercial ventures, however, and contractual provisions limiting liability are not generally understood to be contracts of adhesion or unconscionable restrictions in the commercial context. So long as such limitations are not seen as creating exculpatory release from an actor's own bad faith, gross negligence or wilful and immoral conduct, it is not likely that express liability limitations could be deemed unenforceable.

7. Risk, Insurance and Securities

7.1 Indemnities

Nevada generally will enforce any type of indemnity provision, whether indemnifying a person for the indemnitor's actions only ("Type 3"), when the indemnitor is contributorily negligent with the indemnitee ("Type 2"), or even if the indemnitee is solely negligent ("Type 1"), as Nevada has not enacted any anti-indemnity statutes to date. Of late, however, the Court has begun construing indemnification clauses more strictly and placing specific language requirements on these clauses. In *George L. Brown Ins. v Star Ins. Co.*, 237 P.3d 92, 126 Nev. 316 (Nev. 2010), the Court placed specific limits on the language of a Type 1 indemnity agreement in order to make that obligation enforceable. Specifically, the Court requires a Type 1 indemnity provision to specifically state that the indemnitor is indemnifying the indemnitee from its own negligence to be enforceable. The Court stated:

"[A]n express or explicit reference to the indemnitee's own negligence is required to indemnify an indemnitee for his or her own negligence

because "the character of [such an] indemnity [is] so unusual and extraordinary, that there can be no presumption that the indemnitor intended to assume the responsibility unless the contract puts it beyond doubt by express stipulation, and no inference from words of general import can establish it."

The Court expressly rejected the "modern minority rule" which allowed general statements such as "any and all claims" standing alone to be sufficient to establish Type 1 indemnity obligations.

In *Reyburn Lawn & Landscape v Plaster Dev. Co., Inc.*, 127 Nev. 331, 255 P.3d 268 (2011), the Nevada Supreme Court extended this "expressly or explicitly provided" test to Type 2 indemnity provisions, ie, those indemnity provisions allowing for complete indemnification of the indemnitee, even in the circumstance of contributory negligence of the indemnitee. The Court noted that, just as in Type 1 sole indemnity obligations under *Brown Insurance*, an indemnification clause must explicitly or expressly state that the indemnitor will indemnify the indemnitee for the indemnitee's contributory negligence. A general statement of indemnity will not suffice.

In 2012, the Court extended the *Reyburn* decision, finding that the use of the limiting language "to the extent caused in whole or in part by" the indemnitor, in a contractual indemnity provision will require (both for indemnity and defence) that causation by the indemnitor be shown before an obligation to indemnify and defend arises. *United Rentals v WellsCargo*, 128 Nev. 666, 289 P.3d 221 (2012). This applies to both sole and contributory negligent situations. Further, the Court noted that the contractual indemnity language would be strictly construed to impose indemnity obligations, and that the naming of the indemnitee as an additional insured under any

applicable insurance policy would not alter the outcome when the indemnity provision uses the “to the extent caused by” language.

Given these factors, the Court seems intent on limiting the reach of general indemnity provisions. As such, the safest approach is to spell out, as specifically as possible, the reach of an indemnification clause.

It should also be noted that, in the context of residential construction defect litigation, the Nevada legislature enacted NRS 40.693, which effectively limited indemnity obligations of subcontractors to general contractors to Type 3 indemnity obligations and imposed significant restrictions on wrap insurance coverage policy requirements. These restrictions should be carefully considered when negotiating subcontract agreements for new residential construction projects.

7.2 Guarantees

There are few mandatory warranties that apply to construction projects within Nevada. However, unconscionable contracts or provisions when made can be challenged on that basis. Implied warranties of fitness for particular purpose and of merchantability will apply to goods and products which some case law in Nevada would consider residential structures when newly constructed. Disclaimers of such warranties have not been effective.

In general, residential projects are considered “defective” when, as a whole or in their component parts, their design, construction, manufacture or repair (including landscaping) presents “an unreasonable risk of injury to a person or property or are not completed in a good and workmanlike manner” and cause injury or damage. See NRS 40.615. This definition would

arguably not directly apply to a commercial structure, although, in that context, the warranty or guarantees would more likely be specified in the contractual agreements for their construction. Nevada courts would likely enforce those provisions in a commercial context.

7.3 Insurance

Typically, insurance policies within the construction context are those found in other commercial endeavours. General Commercial Liability insurance coverage for operations, Completed Operations Coverage, Automobile and Equipment Coverages, Workers Compensation and Umbrella liability coverage policies are routinely requested and expected. Per occurrence and aggregate policy limits are determined based on contractual limits and potential liability for the construction activities and their relative levels of danger.

Additional coverage is often provided based on risk tolerance of the parties during the contract negotiation phases. Builders Risk coverage for damages to in-progress work is routine on larger projects. Wrap insurance programmes on a Project basis are often used for their consistency of coverage and economic incentives to the Project funding mechanism.

Concerns on all policies are any dwindling and depreciating limits on policies for other projects which would also be covered by a contractor’s insurance limits. Nevada has recently passed restrictions on such depreciating limits for costs of defence and attorneys’ fees in the context of certain types of claims. Riders to cover such expenses outside the limits of the policy coverages should be considered.

7.4 Insolvency

State law in Nevada does not impact construction contract clauses, making filings for protection under United States Bankruptcy laws or state receivership laws cause for default, and does not distinguish between parties in that context. However, caution must be exercised before attempting to enforce such provisions when a party has filed for protection under United States Bankruptcy law. In such cases, under 11 USC § 362, an automatic stay of any adverse action against the bankrupt entity is prohibited and subjects the action-taker to court sanctions, including fines. While notices to secure contractual rights may be issued and certain preliminary steps taken to secure the non-bankrupt party's rights, no specific adverse action may be undertaken without lawful order of the presiding Bankruptcy Judge. Before taking any action, a local practitioner in United States Bankruptcy law with experience in handling construction matters in that particular context should be consulted.

7.5 Risk Sharing

In Nevada, risk-sharing contracts and provisions have not gained much traction in the construction industry. The more traditional methods of passing risk of loss and liability through contract provision and indemnity obligations, insurance, surety bonds, and other mechanisms remain the preferred options. Modern risk-sharing delivery methods, such as Integrated Project Delivery and other options, have not seen much traction in the local construction industry, with Construction Management and Design Build concepts significantly preferred as risk lowering options.

8. Contract Administration and Claims

8.1 Personnel

Construction contracts dealing with personnel are usually limited to provisions establishing acceptable cost levels for personnel passed along to the Project owner in cost-plus contract options, or not disclosed beyond general conditions schedules of values for labour and labour-burden rates. Contractual provisions requiring superintendents to be able to understand and speak the English language, to remain on site daily or weekly, and to maintain control over their labourers' and their own conduct, are routine. Contractual obligations to remove certain managerial or supervising personnel at the owner's reasonable request are also routine.

On public projects and commercial projects subject to union contracting labour agreements, obligations for conforming to applicable prevailing wage laws, project labour agreements and/or union labour agreements are also routine.

8.2 Subcontracting

Typical provisions regarding subcontracting in construction contracts will allow subcontracting portions of the work to properly licensed subcontractors who perform the assigned tasks for the general contractor. Prohibitions of assignment of the entire contract from one general contractor to another are mostly prohibited.

8.3 Intellectual Property

In most construction contracts dealing with intellectual property rights, general contractors are required to indemnify, defend and hold owners harmless from violations of intellectual property rights of third parties violated as part of the contractors' work, means and methods of construction. Intellectual property rights of

design professionals in their design concepts and instruments of service are reserved to the design professionals under applicable Nevada state law, and only licensing of the right to use such intellectual property in the construction of the design are allowed, without further authorisation of the design professional holding such rights.

9. Remedies and Damages

9.1 Remedies

Remedies available within Nevada are mostly contract based, with limited exceptions in the context of payment and performance rights.

In the context of public works construction, public owners are limited in their remedies to breach of contract remedies as well as enforcement of performance surety bond obligations, which ensure the project will be completed on a timely basis and at the cost agreed with the Contractor. A contractor's right to payment is only protected by the contractual right against the public entity contracting for the work. However, statutory rights to enforce payment by petition to the courts on an expedited basis, as well as the payment of interests on past-due funds, is available. For subcontractors and suppliers to the third tier only, payment is also protected by the availability of a payment surety bond, and prompt payment remedies.

On public projects, Nevada law does not provide significant protections to an owner of the project beyond its contract and claims on surety bonds of limited liability to ensure compliance with the Nevada Contractors License laws, found at NRS Chapter 624. However, on private projects, Contractors, subcontractors and suppliers have, in addition to their contractual rights, a right to

assert and enforce a Mechanic's Lien right to sell the owner's property and recover payment. Contractors on private projects also have rights under the NPPA, discussed previously herein, to stop work and terminate a contract early for lack of timely payment.

9.2 Restricting Remedies

Outside of the design professional context, it is unusual for limitations on damages to be used in construction contracts. In contracts with design professionals, liability is often limited to the total value of the design contract, which is often substantially less than the value of a construction contract. Enforceability of such damage limitations in design contracts has not been judicially tested in any reported case decisions in Nevada. Waivers and limits on the rights of mechanics liens or rights afforded to contractors under the NPPA are generally prohibited by statute.

9.3 Sole Remedy Clauses

Within the context of design professional contracts, it is not unusual to see provisions limiting the liability of individual licensed professionals to that of the corporate entity out of which they operate. Such provisions, however, are likely not enforceable as the entities can only operate in Nevada through the licence of the individual professional.

9.4 Excluded Damages

In general, many types of damages may be restricted by contract, unless statutorily prohibited or prohibited through public policy declarations. Most often, consequential damages are waived via contractual provision. For contractors, however, the waiver of consequential damages is limited by certain provisions of NRS 108.2453(2)(e) in the context of delay, disruption, and other kinds of time-impact damages.

9.5 Retention and Suspension Rights

Retention is authorised by statutory provision, not to exceed five percent (5%) of the payment amount made, except with specific notice provisions and in specific circumstances.

Likewise, Contractors have specific rights to suspend performance in the event of late or non-payment under the NPPA.

Owners retain the right to withhold payment for specific items and contexts under the NPPA. They also may suspend work when contractual provisions allow for such suspension.

9.6 Termination

Contractors maintain a statutory right for termination of a construction contract for continued lack of timely payment, upon certain notice requirements under the NPPA (see **3.2 Variations**). Owners similarly may terminate a construction contract under the NPPA when a dispute leads to the Contractors work stoppage. Otherwise, termination is usually handled through contractual provision, which typically allow for termination for cause/default of the contractor, and for the owner's convenience. Such contractual provisions are not routinely provided to the Contractor, except for non-payment issues.

10. Dispute Resolution

10.1 Regular Dispute Resolution

Nevada trial courts are divided by dispute value, depending on the jurisdiction. In Clark County, Nevada (where Las Vegas is located), disputes under USD15,000 in value are handled by the Nevada Justice Court system and its divisions and disputes over USD15,000 are handled by the Nevada District Court System. The District Courts are also charged with evaluation of title to real property and are therefore appropriate venue for mechanics lien disputes, regardless of the value of the dispute. In smaller jurisdictions, such as those located in Carson City or Lyon County, the division amount between these courts is less, typically USD10,000.

10.2 Alternative Dispute Resolution

Nevada construction projects routinely use alternative dispute resolution mechanisms to resolve construction disputes. Mediation, arbitration and dispute resolution boards are typically seen as workable alternatives, when negotiation fails to resolve disputes. Nevada statutorily regulates arbitration by provisions found in NRS Chapter 38. Form construction contracts often contain arbitration clauses mandating that arbitration be conducted by specific forums, such as the American Arbitration Association, which can result in higher costs than other alternatives.

CHAMBERS GLOBAL PRACTICE GUIDES

Chambers Global Practice Guides bring you up-to-date, expert legal commentary on the main practice areas from around the globe. Focusing on the practical legal issues affecting businesses, the guides enable readers to compare legislation and procedure and read trend forecasts from legal experts from across key jurisdictions.

To find out more information about how we select contributors, email Katie.Burrington@chambers.com