

New Standard Forms of International Construction Contract



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The influence of FIDIC's forms on international construction practice continues to be significant. Consequently, the publication, in 1999, of a new set of standard forms is an important event. This article reviews and comments on these new forms.

For more than 40 years, the *Fédération Internationale des Ingénieurs-Conseil* (the International Federation of Consulting Engineers – FIDIC), which has its headquarters in Lausanne, Switzerland, has prepared and published standard forms of construction contract for international use.¹ The FIDIC forms, which were prepared after wide consultation within the international construction industry, international financing institutions, such as the World Bank, and the International Bar Association, are the most widely used standard forms of international construction contract. Even when these forms are not used directly, they are an accepted reference point or norm by which other standard forms of construction contract for international use, as well as individually drafted construction contracts, are judged. Clauses derived

from FIDIC's forms can be discerned in standard forms of construction contract issued by public bodies, such as ministries of public works, power or electricity, or in forms used by private entities in buy-operate-transfer (BOT) or similar type of project, around the world. The influence of FIDIC's forms on international construction contract practice has been, and continues to be, far-reaching. The issue by FIDIC of a new suite of standard forms to take account of developments over the past decade or so, and to replace its existing forms, is therefore a notable event in the international construction industry.

Late in 1999, FIDIC published four new standard forms as follows:

- (1) *Conditions of Contract for Construction* (for building and engineering works designed by the employer) (the 'new Red Book');
- (2) *Conditions of Contract for Plant and Design-Build* (for electrical and mechanical

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plant and for building and engineering works designed by the contractor (the 'new Yellow Book');

- (3) *Conditions of Contract for EPC Turnkey Projects* (EPC being the abbreviation for engineer-procure-construct) (the 'Silver Book'); and
- (4) *Short Form of Contract* (for projects of relatively small value) (the 'Green Book').

The purpose of this article is briefly to review and comment on these new forms or books.

Description of the new forms

The new books are not directly comparable to the old (pre-1999) FIDIC standard forms of construction contract. It will be recalled that FIDIC's old forms of construction contract were:

- (1) *Conditions of Contract for Works of Civil Engineering Construction*, fourth edition, 1987 (reprinted in 1988 with editorial amendments and reprinted in 1992 with further amendments) (the 'old Red Book');
- (2) *Conditions of Subcontract for Works of Civil Engineering Construction*, first edition, 1994 (to function with the old Red Book);
- (3) *Conditions of Contract for Electrical and Mechanical Works*, third edition, 1987 (reprinted in 1988 with editorial amendments) (the 'old Yellow Book'); and
- (4) *Conditions of Contract for Design-Build and Turnkey*, first edition, 1995 (the 'Orange Book').

In 1996, FIDIC published a Supplement to the old Red Book providing for:

- (a) a dispute adjudication board (DAB) as an 'acceptable alternative' to the engineer's former role in dispute resolution (the DAB had already been provided for in the general conditions of the Orange Book published in 1995);
- (b) optional amendments to the old Red Book to enable payments to be made on a lump sum basis instead of on the basis of a bill of quantities; and
- (c) an optional amendment to the old Red Book to safeguard the contractor in case the engineer was late in certifying payment (the old Red Book only protected the contractor where the employer paid late, not where the engineer certified late).

Similarly, in 1997, FIDIC published a Supplement to the old Yellow Book providing, again, for a DAB as an acceptable alternative to the engineer's former role in dispute resolution.

Although the new Red and Yellow Books follow the same principles and philosophy as their predecessors, they are considerably different in actual structure, layout and wording. A shortcoming of the old Red and Yellow Books was that, as they had been prepared by different drafting groups, they were drafted quite differently, even when dealing with subject matter that was (or should be) common to both, eg:

- (a) the old Yellow Book contained a *force majeure* clause whereas the old Red Book provided, instead, for 'special risks';
- (b) the old Yellow Book contained a clause dealing with 'limitations of liability' whereas the old Red Book did not; and
- (c) the procedures for requesting engineers' decisions on disputes were not the same in the two Books.

It was difficult for FIDIC to justify issuing two separate standard forms of contract dealing with the same or similar subject-matter in a different way for no apparent reason. This placed an unnecessary burden on users, who were obliged to familiarise themselves with more contract clauses and procedures than should have been necessary.

One of the aims of the new forms was therefore to harmonise clauses, definitions and wording, across all the new forms, whenever this could be justified, and, in particular, in the new Red and Yellow Books. With this goal in mind, the old Red and Yellow Books were restructured (and the new Silver Book was structured) so that they would all be based upon 20 main clauses, as had been true of the Orange Book published in 1995, and the wording of clauses and definitions was made the same or similar where appropriate. The goal of harmonisation was facilitated by assignment of the responsibility for the drafting of the new Red, Yellow and Silver Books to a single FIDIC task group and by requiring that it coordinate closely with the task group responsible for the new Green Book (for small works, as indicated above).

Another structural change is that the new Red and Yellow Books are not broken down strictly between 'civil' and 'electrical and mechanical' forms, as before, but between 'building and engineering works designed by the employer' (the new Red Book) and 'electrical and mechanical plant, and for building and engineering works, designed by the contractor' (the new Yellow Book).

In the case of both the new Red and Yellow Books, administration of the contract and supervision of the execution of the works is carried

out by the engineer who is employed by the employer, as is the case in the old Red and Yellow Books. However, as regards dispute resolution, the DAB is no longer merely an 'acceptable alternative' to the engineer (as indicated in the 1996 Supplement referred to above), but has now firmly replaced the engineer in the general conditions of both the new Red and Yellow Books.

The Orange Book has been effectively replaced by the entirely new Silver Book (as well as by the new Yellow Book). While preparing the new Books, FIDIC concluded that there was a market demand for an entirely new standard form of contract for turnkey projects which, while allowing the contractor a correspondingly higher contract price, would provide the employer (so it was believed) with greater certainty of final price and greater assurance that the final completion date would be respected. As stated in the introductory note to the first edition of the new Silver Book:

'During recent years, it has been noticed that much of the construction market requires a form of contract where certainty of final price, and often of completion date, are of extreme importance. Employers on such turnkey projects are willing to pay more – sometimes considerably more – for their projects if they can be more certain that the agreed final price will not be exceeded. Among such projects can be found many projects financed by private funds, where the lenders require greater certainty about a project's costs to the Employer than is allowed for under the allocation of risks provided for by FIDIC's traditional forms of contracts. Often the construction project (the EPC – Engineer, Procure, Construct – Contract) is only one part of a complicated commercial venture, and financial or other failure of this construction project will jeopardize the whole venture.

For such projects it is necessary for the Contractor to assume responsibility for a wider range of risks than under the traditional Red and Yellow Books. To obtain increased certainty of the final price, the Contractor is often asked to cover such risks as the occurrence of poor or unexpected ground conditions, and that what is set out in the requirements prepared by the Employer actually will result in the desired objective.'

The new Silver Book is FIDIC's response to this perceived market demand.

While FIDIC's standard forms of contract have traditionally observed the principle of balanced risk

sharing between the employer and the contractor, the new Silver Book avowedly – and unashamedly – places more risk on the contractor than FIDIC's traditional standard forms. Among other things, the contractor is made responsible for the accuracy of the 'Employer's Requirements' (ie the design parameters supplied by the employer on the basis of which the contractor is expected to develop his design), as well as for unforeseeable conditions, including underground conditions (but subject to a *force majeure* clause).

However, as is well known, merely transferring risks indiscriminately from the employer to the contractor will not necessarily better ensure that the works are done on time or at the agreed price. Instead, this may, at best, cause more claims and disputes and, at worst, bankrupt the contractor, thereby requiring the employer to re-bid the job and, almost inevitably, pay a higher price to get the work done.

Acknowledging this, FIDIC cautions, in its introductory note to the Silver Book, that the form is not suitable for use where, among other things, construction will involve substantial work underground or work in other areas which tenderers cannot inspect or if there is insufficient time or information for tenderers to scrutinise and check the employer's requirements or for them to carry out their designs, risk assessment studies and estimates. In such cases, FIDIC accepts, the contractor would be required to assume risks that he cannot reasonably be expected to evaluate which would not be in the interest of either party. Accordingly, in these situations, FIDIC recommends that the new Yellow Book be used, which provides for balanced risk sharing between the employer and the contractor.

As indicated by the above quotation, the new Silver Book is intended for use as an EPC contract within a BOT or similar type of structure, and also for other types of project where government departments, private developers or others wish to implement a project on a fixed turnkey basis with a strictly two-party approach, ie without the intermediary of the engineer.

The fourth new book, the *Short Form of Contract* (the general conditions are only ten pages long), which is also called the 'Green Book', is entirely new. It is basically intended for building and engineering works of relatively small capital value (typically under US\$500,000) or for relatively simple or repetitive work, or work of short duration (typically six months or less). Until this Book was

issued, there was no FIDIC short form of contract for use in international construction.

Innovations made by the new books for major works

Within the confines of this brief article, it is not possible to examine each of the above new standard forms in detail.² However, some of the innovations that have been introduced into the three new Books for major works may be illustrated by reference to the following new provisions in the new Red Book which, I suggest, either (a) favour the contractor, or (b) favour the employer. In most instances, the new Yellow and Silver Books contain identical or similar provisions.

New provisions favouring the contractor

New provisions which may be said to favour the contractor include the following:

- (1) The employer is required to submit, within 28 days after receiving any request from the contractor, 'reasonable evidence that financial arrangements have been made and are being maintained' which will enable the employer to pay the contract price in accordance with the contract. If the employer intends to make 'any material change' to his financial arrangements, he is required to give notice to the contractor with detailed particulars (sub-clause 2.4).
- (2) If the employer considers himself to be entitled to any payment under or in connection with the contract, and/or to any extension of the defects notification period (the new name for the defects liability period), the employer or the engineer must give 'notice and particulars' to the contractor. The particulars must 'specify the Clause or other basis of the claim . . . and . . . include substantiation of the amount and/or extension to which the employer considers himself to be entitled'. The notice must be given 'as soon as practicable' after the employer became aware of the event or circumstance giving rise to the claim. The employer is expressly denied the right to set off against or make any deduction from a certified amount or otherwise claim against the contractor, except in accordance with this provision (sub-clause 2.5).
- (3) The contractor's right to adjustment of the contract price to take account of any increase or decrease in cost (as defined) resulting from a change in law in the country where the site is

located has been extended (beyond 'changes in legislation', as, for example, in the Orange Book) to include changes 'in the judicial or official governmental interpretation' of laws made after the base date (as defined), which affect the contractor in the performance of his obligations (sub-clause 13.7).

- (4) If the contractor is not paid on time, the contractor is entitled to receive 'financing charges compounded monthly on the amount unpaid during the period of delay'. Unless otherwise stated in the particular conditions, these financing charges are to be calculated at the annual rate of three percentage points above the discount rate of the central bank in the country of the currency of payment and should be paid in such currency (sub-clause 14.8).

The above provision is derived from the Orange Book. While the old Red Book provided that the contractor was entitled to interest on late payments, it did not specify how this was to be calculated.

- (5) The contractor is now entitled, after giving notice, to suspend or reduce the rate of work where the engineer fails to certify an interim payment certificate or the employer fails to provide information about the employer's financial arrangements for paying the contract price (see point (1) above) (sub-clause 16.1).

Under the old Red Book (sub-clause 69.4), the contractor was only entitled to suspend or reduce the rate of work where the employer was not paying an amount due under any certificate.

- (6) Within 42 days after receiving a claim or any further particulars supporting a previous claim of the contractor, the engineer is now expressly required to 'respond with approval, or with disapproval and detailed comments' (sub-clause 20.1). Under the old Red Book, there was no express requirement that the engineer respond to the merits of the contractor's claims at all, except in the case of a dispute (clause 67).
- (7) Under the general conditions of the new books for major works, disputes are now required to be submitted to a DAB for decision. In the case of the new Red Book, the DAB must be appointed at the time the contract is signed and remain in place until it is concluded (under the general conditions of the new Yellow and Silver Books, a DAB is appointed for each dispute and ordinarily only remains in office until that dispute is decided) (clause 20). Under the old Red and Yellow Books, disputes had to be submitted to

the engineer for a decision, as a condition to arbitration. The provision for a DAB to replace the engineer for the settlement of disputes in the general conditions may be the most favourable of the innovations in the new books from the contractor's point of view.

New provisions favouring the employer

New provisions which may be said to favour the employer include the following:

- (1) The employer is now entitled, on not less than 42 days' notice, to replace the engineer provided that the employer may not replace the engineer with a person against whom the contractor 'raises reasonable objection' by notice to the employer (sub-clause 3.4). Under the old Red Book, the employer had no right to change the engineer (sub-clause 1.1(iv)).
- (2) If the contract specifies the contractor shall design any part of the permanent works (as defined) then such part must, when completed, be 'fit for such purposes for which the part is intended as are specified in the Contract' (sub-clause 4.1(c)). Under the old Red Book, there was no requirement that any works designed by the contractor be fit for purpose.
- (3) Where the contractor makes a claim for adverse physical conditions (as defined) which he considers to have been unforeseeable (as defined), the engineer may review whether other physical conditions (in similar parts of the Works (if any)) were more favourable than could reasonably have been foreseen. If so, the engineer may reduce the amount of any cost (as defined) claimed by the contractor for adverse physical conditions by the amount of the reduction in cost of such more favourable conditions, so long as the net effect does not result in a reduction in the contract price (sub-clause 4.12).
- (4) The contractor is required to submit detailed monthly progress reports to the engineer, including charts and detailed descriptions of progress, photographs showing the status of manufacture and of progress on the site, details regarding the manufacture of each main item of plant and materials, records of the contractor's personnel and equipment as well as other information (sub-clause 4.21). Such progress reports are required to accompany the contractor's applications for interim payment certificates (sub-clause 14.3), implying that

payment may be conditional on the receipt of such reports.

- (5) The employer is expressly entitled to extend the defects notification period for the works or a section of the works for up to two years if it cannot be used for the purposes for which it was intended by reason of a defect or damage (sub-clause 11.3).
- (6) The employer has the right, after notice to the contractor, to terminate the contract at any time for the employer's convenience provided that the employer may not do so in order to execute the works himself or to arrange for them to be executed by another contractor. In the case of such termination, the contractor is paid for work done but is deprived of the right to profit on the balance of the contract (sub-clauses 15.5 and 19.6).
- (7) The contractor is required to give notice to the engineer of any claim for an extension of time or additional payment 'not later than 28 days after the contractor became aware, or should have become aware, of the event or circumstance' giving rise to a claim. If he fails to do so, the employer is stated to be discharged from all liability in connection with the claim. In addition, the contractor is required to send to the engineer 'a fully detailed claim' within 42 days after the contractor became aware, or should have become aware, of the event or circumstance giving rise to the claim (unless the engineer approves a longer period). If the contractor should fail to comply with this latter requirement, any extension of time and/or additional payment must be adjusted to take account of the extent to which the failure may have 'prevented or prejudiced proper investigation of the claim' (sub-clause 20.1).

Conclusion

Not only are the new Red, Yellow and Silver Books different in structure, layout and wording from their predecessors, they are also longer and more detailed, reflecting the increasing complexity and (often) size of international construction projects, as well as the increasing need, in such projects, for more extensive contract administration and supervision. Consequently, users will inevitably require time to become familiar with them. However, as indicated earlier, users should be aided by the identical or similar treatment of common subject-matter (eg *force majeure*, claims and disputes) throughout the

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new books for major works, and should also appreciate the inclusion of:

- (1) helpful charts to illustrate the typical sequences of:
 - (a) 'principal events' during the life of the contracts,
 - (b) 'payment events', and
 - (c) 'dispute events';
- (2) numerous alternative example clauses in the 'Guidance for the Preparation of Particular Conditions' in each book; and
- (3) seven different forms of guarantee or bond, most of which incorporate the excellent (but still little known) new ICC Uniform Rules for Demand Guarantees or Uniform Rules for Contract Bonds.

Consequently, the present author is convinced that, with time, the new books will be widely accepted and will be seen as representing a significant advance over their predecessors. While FIDIC does not presently anticipate issuing a new form of subcontract for the new Red Book (as this is not justified by demand for the existing form of subcontract for the old Red Book), a guide to the new books for major works has recently been published by FIDIC and should be of assistance to all users of the new books, whether or not they are already familiar with FIDIC's pre-1999 standard forms.³ ■

Notes

* Legal Adviser, FIDIC's Contracts Committee. The views expressed in this article are those of the author and not necessarily those of FIDIC's Contracts Committee.

- 1 The first standard form of construction contract issued by FIDIC was the first edition of its *Conditions of Contract for Works of Civil Engineering Construction* (called the 'Red Book') which was published in 1957.
- 2 For a detailed discussion of the clauses of a more legal nature in the new FIDIC forms, see the author's 'FIDIC's New Standard Forms of Contract - Force Majeure, Claims, Disputes and Other Clauses' in [2000] *International Construction Law Review* (ICLR) 235. For articles dealing in detail with other clauses in the new forms, see Christopher Wade, 'FIDIC's Standard Forms of Contract - Principles and Scope of the Four New Books' and Peter L Booen, 'The Three Major New FIDIC Books', both of which appear in [2000] ICLR at 5 and 24, respectively. Messrs Wade, Booen and the author were all members of the FIDIC task group that was responsible for preparing the new books.
- 3 Any reader interested in obtaining a copy of the *Guide of FIDIC's standard forms* should contact Mr Peter van der Togt, Publications Manager, FIDIC, PO Box 86 (Chailly), CH-1000 Lausanne 12, Switzerland, tel: (41 21) 654 44 15, fax (41 21) 654 44 17, e-mail: fidic.pub@pobox.com, website: www.fidic.org/bookshop.