International Construction Contract Law

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Lukas Klee, JD, LL.M., Ph.D., MBA, is an international construction law expert, adjudicator and currently head of the legal department at Metrostav a.s., a large construction company based in central Europe.

For over a decade Lukas has dealt with international construction contracts (FIDIC) on a daily basis and has participated in large construction projects in the Czech Republic and internationally. When away from the office, he lectures on international construction law for example at the Charles University Faculty of Law in Prague, the Czech Technical University in Prague and at the University of Warsaw, Faculty of Law.

Over the course of his LL.M. studies at the Nottingham Trent University and PhD studies at the Charles University Faculty of Law, Lukas focused on FIDIC forms of contracts. His MBA dissertation at Sheffield Hallam University further examined claim management implementation.

Lukas regularly gives lectures for many organizations including FIDIC, provides training, publishes articles worldwide and is the author of several books related to international construction law.

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Foreword

Svend Poulsen
Project Director Atkins, Chairman FIDIC Contracts Updates Task Group

We often hear the word ‘project’ when work needs to be done. ‘I have a project at home’ is a regular phrase in daily conversation. In general, we see more and more of our life as a series of projects. Going on holiday is a project; preparing a dinner with friends can be a project and training for a marathon can be a project. This mindset is likely to be something we have adopted from the construction industry.

One of the first things you notice when starting work in the construction industry is that the unknown has a major impact on any project. You can even divide the unknown into the ‘known unknown’ and the ‘unknown unknown’. The way to handle the unknowns is to use tools developed in the risk management field. These tools have been developed over many years and, when used correctly and continuously, can lead to more successful projects.

We do not know all the risk aspects when starting a project. For example, can we know and predict all the risks and problems associated with an industrial process for mass manufacturing? Designing a new car is a project. Once the design is agreed upon and all the details for manufacture are in place, the task is complete. The next step is industrial production with certainty of performance and quality of the car known – at least in principle.

Projects in the building and construction industry are unique and often only have a limited aspect of industrial process. For example, construction might use some well-defined processes such as the laying of sleepers and rail on a railway using a track-laying machine. However, uncertainty of the sub-soil conditions and other specific local conditions for the completed works will always sow the seed for risks and surprises. During execution of the works, the weather, the market situation, labour availability and so on influence the progress and certainty of achieving the agreed quality, budgeted price and finishing date.

An essential element of any project is the need for good agreements between the parties to a project. Since the 1950s, FIDIC has produced standard contracts for the construction industry. The principles of these contracts focus on fair risk sharing and the most effective mechanisms for administering the project. FIDIC contracts for construction and design-build make the Engineer the responsible party for administering the contract and managing the project. Thus, FIDIC contracts are two-party agreements for a three-party process.

The role of the Engineer is an issue that is often discussed. As an example, how can the Engineer avoid actual or apparent bias towards/against the contractor when being paid by the employer? The Engineer is an agent of the employer but their job is also to act fairly when making determinations under the contract. Contract conditions do state this obligation and it is paramount for the correct administration
of contracts that the assigned Engineer acts in accordance with this requirement. One of the advantages of having an Engineer and not a project manager is that the Engineer has the technical understanding of the project complexity and can manage the project so that questions and unforeseen events are handled properly. Therefore, it is very difficult to succeed with a complex project without the right understanding of the contractual arrangements and the nature of the project.

In the construction business, various kinds of standard contracts are available and set different priorities depending on where they are from. Some have a very strong focus on administrative procedures and are very prescriptive. Others set up a standard framework for the contract and are very dependent on a set of special or particular conditions. Thus, choosing the right form of contract from the outset is critical. The employer should think about how they want to monitor the project and handle risks. On one side of the spectrum are the works designed by the employer and, on the other, turnkey agreements. Some extreme versions of the latter place all risk on the contractor. Risk and influence, therefore, go hand in hand.

Transfer of all risks to the contractor under a turnkey form of contract gives the contractor full control of the processes to mitigate consequences of risks. The employer has to accept that by transferring risk, they also transfer control. Why is this form of contract so popular then? Answer: the industry has seen a growing need for certainty of price and time. Financial institutions focus on budgets and time more than ever. Under these circumstances, it is extremely important that the technical requirements for the project are well defined because changes at a later stage are, in principle, not possible.

The reader of this book will see that there are a lot of people in the industry striving to make projects successful and they put in a lot of effort into improving contracts, procedures and tools to become even better at managing complex projects. Our industry has produced spectacular achievements throughout modern history. In particular, the world’s need for efficient transport has been a huge driver for the engineering industry. When new and more efficient transport is introduced, society prospers. Today the focus on sustainability also influences the way we design and construct. New ways of working, new ways of co-operating and new types of projects call for new types of agreements.

Whether you read this book from cover to cover or as reference guide, you should realize that because of this book your contribution to more successful projects will have a higher value. The book gives you access to a treasure chest of knowledge collected by experienced engineers and contract managers – experience you can use when faced with the challenges that projects bring – challenges that arise from the basic fundamental nature of projects themselves.

We who work with projects know that successful projects give out positive energy and a good feeling of developing our society. With this book in hand, it is now your turn to feel the power of this positive energy.
Acknowledgements

Many thanks to Andrea, Sam, Ben and the whole family for your understanding and endless support. I could not have done it without you.

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Many thanks to all my friends and colleagues who contributed with a vignette or helped with particular chapters. Your worldly insights have given this book a truly global perspective:

God says, ‘If as one people speaking the same language they have begun to do this, then nothing they plan to do will be impossible for them.’ (Genesis 11:6)

The modern era has brought with it a never-before-seen demand for high quality and high quantity civil infrastructures and industrial facilities. Their importance cannot be underestimated in raising the living standards of human beings, particularly in developing countries. Estimates of global demand for infrastructure over the next decade is somewhere between US$10 to 20 trillion. Meanwhile, with the advances in productivity, construction projects are getting larger in scope and more complex in technology. They usually involve an input of vast resources, including human expertise, equipment and various materials, among other things. This makes it very hard, if not impossible, for a single country or region to cope alone. In addition, comparative advantages make it more likely and efficient for construction-related firms from all over the world to work on the same project. As a matter of fact, large and global projects are ubiquitous on current international construction markets. Take China’s World Bank-financed Xiaolanglangdi Multipurpose Hydro Project as an example. More than one hundred organizations participated in the construction, including contractors, subcontractors, suppliers and consultants, from over fifty countries/regions. This project was thus nicknamed the ‘small United Nations’. According to the Engineering News Record, the overseas turnover of the top international 225 contractors has been increasing for the past 10 consecutive years, reaching a total of US$511 billion in 2012 compared to US$116 billion in 2003. This indicates an annual average growth rate of more than 15%.

Indeed, the construction industry has been globalizing with the globalization of the whole world. However, globalized construction projects are temporary and inter-organizational activities and require intense communication and coordination efforts from many participants who possess different cultural and legal backgrounds. Such institutional differences tend to act as obstacles and pose problems in communication among project participants, resulting in poor coordination, misunderstandings, chaos, and even unfortunate project failures. The very recent project of the A2 motorway in Poland undertaken by a Chinese contractor is a good illustration of the latter situation. The frequent occurrence of disputes in international construction is an ever-occurring phenomenon. Therefore, a good mechanism must be designed to alleviate such a situation – namely, the construction contract. This document, at its core, is designed to make all participants speak the same language.
Project contracts are legally enforceable and binding, and managerially instrumental, offering ‘the rules of play’ to act as a guide for the parties to work together. To cooperate efficiently and effectively, it is a must for all parties involved in international projects to have a good understanding of the rules first. However, due to the very nature of construction contracts and the different legal systems governing each individual contract, confusion may arise in the understanding, interpretation and execution of a given contract. For construction project professionals in general, this presents a challenge unless they are well informed with sound knowledge of construction-related contractual and legal issues. To the best of my knowledge, very few books on the market are available to explicitly deal with this topic.

I am pleased to learn that Dr. Lukas Klee, an experienced lawyer in international construction, has filled this gap with this new book that specifically targets international construction contracts in practical terms. This book covers the key legal and contractual knowledge areas for international construction, such as civil law/common law interrelationships, delivery methods, standard forms of contracts, risk allocation, variations, claims, dispute resolution, insurance and securities. Accompanying these subjects, the lessons learnt from the industry and around 50 vignettes collected from more than 15 countries and all continents make this book a real ‘international’ and ‘practical’ guide. The comprehensive knowledge conveyed in this book, in my personal judgement, will perfectly cater for the urgent needs of international construction professionals.

I am confident that this new book will be a great help to professionals allowing them to speak the same construction language in international projects and, in turn, will facilitate them in building a *stairway* to a better world in an efficient and harmonious way.
Introductory Remarks

Robert Werth
Owner of werth-consult engineering and consultancy services Essen, Germany

Construction law literature is usually written by lawyers for lawyers. This often means that texts are very technical and contain a lot of law-related jargon. To a large extent this is necessary but may exclude or ‘scare off’ the majority of construction project practitioners.

From my daily business dealings I have seen that the biggest issues in international contracts are managing communication, understanding and the behaviour of people. We all know that international contracts are usually large, complex documents and we could assume that the people involved have the proper skills to do the job. But do these people have the proper skills under the conditions agreed to under the terms of the contract? Many construction project participants (usually engineers) use the skills gained from working with domestic construction contracts and apply this knowledge internationally. Effectively, this often means that the job goes ahead, irrespective of what the contract says. This approach may be correct from a technical aspect but riskier when considering the administrative requirements under international contracts.

For these reasons, the most important issues for management staff when dealing with international contracts is an understanding of (1) the contract itself; and (2) the legal system in which it operates.

The advantage of this book is that it covers all important international construction law aspects in a comprehensible, easy-to-read and user-friendly manner. This helps find the common understanding of an issue before it can be discussed in terms of specific contract conditions in a particular case. It is an essential reference for all parties involved directly or indirectly in international construction projects.

This book is particularly helpful because it contains a number of practical examples from real ‘on-site’ experience that can assist the practitioner immerse themselves quickly into the specifics of construction projects. This also makes the book interesting and ‘readable’.

I highly recommend this book to anyone involved in international construction contracts.
My experience with international contracting in Eastern Europe, Russia and the CIS began twenty years ago. Despite the international prominence of commonly applicable construction practices (for example, under FIDIC standard forms of contract) their use and implementation in construction projects are relatively unknown in Russia and the CIS. In these regions, domestic industries work on the basis of traditional workflow documentation and contract writing dating back to the socialist era. This can cause significant problems when international construction projects ‘come to town’. Typically, there is conflict of expectations of accepted standards of contract and the rights and responsibilities of the parties.

In a fast moving and globalized world, local participants need a quick-reference guide to manage their expectations in an international construction project environment. As a professional in this field, I have many books in my legal library dealing with construction projects. However, all of these references are limited in their scope to a particular legal system or territory of implementation. Prior to the publication of this book I had no materials that provided universal coverage of construction topics at a global level.

Construction disputes are infamous for being costly, lengthy and voluminous. In an industry where ‘time is money’ more than anywhere else, participants in the field need knowledge, a calm head and oversight to minimize delays and keep the project moving. This book is a vital tool for making this possible. Therefore, it is of great benefit to all private consultants involved in the industry. For example, engineers in developing countries and emerging markets where international practices of implementation of infrastructure projects are just becoming known will find it particularly useful. The title will also appeal to in-house counsel and privately practising lawyers for whom construction law is not their mainstream practice area. It’s also a ‘must read’ for the wider audience of consultants, surveyors, architects and executives of project owners, employers (public and private) and domestic construction industry specialists.

The style of this book is characterized by its practical approach, lucidity of text and clarity. The author’s experience, know-how and international perspective as in-house counsel of a major construction company make him perfectly positioned to write this text.

The book has the further advantage of being written by an author from a non-common law country that has just recently begun to implement international contracting practices. His exposure to these matters provides readers with a unique, fresh and unbiased look at the subject matters as they stand today, for example, the
chapters on claims and claims management. These two chapters are literally ‘from the front lines’ and convey the author’s experiences in a practical way.

The majority of prominent publications are written by Anglo-American authors. Mr. Klee was trained and practises in a European law setting. The legal system is based on Roman and Napoleonic Law principles which operate not only in continental Europe, but also in South-East Asia, the Middle East, Africa and South America. For this reason, readers in these jurisdictions will find this title an invaluable, relevant and user-friendly tool to solve daily questions that arise in construction, for instance, how to apply the standard forms of contract developed in common law countries locally. Common law practitioners will similarly benefit from knowing what to expect when dealing with colleagues and partners in non-common law countries.

Another key feature of this book is the fact that the author is not a native English speaker. Most of the forms and precedents relating to the subject matter are in English. Thus, the author is in the best position to assess ‘translation difficulties’ – in other words, managing the linguistic aspect. Readers will become familiar with technical terms used in the industry. Moreover, the reference material included in the Appendices – tables, a dictionary of construction terms, and FIDIC forms add great value and facilitate learning. This treatise is an information source which the reader will turn to time and time again as construction project demands unwind and develop.

International supranational construction law lives and develops primarily through arbitration. Arbitration awards are not systematically published and the counsels who participate ‘learn by doing’. Unfortunately, the benefits of experience of arbitration are seldom passed down to other participants of construction projects (including to those whom counsel represent). The book is generously enriched and illustrated by case studies and references to arbitration awards, decisions and findings of arbitration tribunals. It is an entertaining and excellent supplement to the black letter law.

We have all been told to write in plain, easy-to-understand terms, to avoid legalese and to employ construction industry terms where possible while maintaining accuracy. This is not always an easy thing to do. The title successfully implements these principles and empowers its readers.

There is a clear need and niche for this publication for many readers from across the globe – notably in new independent states and developing countries. The author approaches the subject matters from their standpoint – that is, a non-native English-speaking construction project participant in a new economy where the forms and principles may not be familiar to them. Dr Klee’s practical and concise approach to issues will be welcomed by the busy practitioner.
1.1 The unique nature of the construction industry

The construction industry does not have clearly defined borders and its characteristics range from simple to complex. Construction supplies basic materials (such as aggregate, cement, steel reinforcement and pre-packaged mixtures) right up to cutting-edge technology developed and used by experts. The industry has contributed to, and is a vital element of, almost everything we see around us. For example, the diversion of water courses, land reclamation, houses, shopping centres, offices, factories, health care facilities and large infrastructure-related civil engineering works such as bridges, tunnels, highways, airports and harbours. Others installations include water treatment plants, dams, nuclear power plants, wind power plants and projects in the field of electricity generation. The contribution made by the construction of factories, warehouses and production lines that serve other industries, (including mining and research centres) cannot be ignored. The particular activities relate not only to new construction works, but also repairs, extensions, reconstructions and demolitions.

The diverse nature of the construction industry reflects the complexity of contemporary society as a whole, leading then to necessary specialization of particular activities in construction. A construction project is further comprised of complex processes, services and supplies reaching beyond the scope of this industry alone. For example, insurance, financing, bonds and guarantees, purchase of plant and equipment, security guards, operations and maintenance of work processes.

1.2 Individuality of construction projects

A construction project is a specific process or, rather, a sum of many processes. Mostly, it is an individual process. There are variables relating to the positions of its participants, their assignments and relationships, external conditions (concerning the economy, the nature of the site, climatic conditions, project risk and hazard
levels in general), project management and delivery methods, procurement methods and public support.

Construction projects face hazards of various kinds, caused either by humans or natural elements. Therefore, people, time and environmental elements play a major part here. The construction project itself tends to be a unique set-up of processes with unpredictable impacts caused by individual hazards. For large construction projects, their duration will often exceed two years. These projects are realized over extensive areas and are often difficult to safeguard perfectly. Therefore, a construction project is not a production line you can just program to smoothly create a product, within a well-defined time, quality and financial outlay.

Design errors, extremely adverse climatic conditions, unforeseeable on-site conditions in physical or social terms, site access-related issues, building permit problems, delays due to the requirements of environmentalists and variations are just some examples of potential complications.

Effective risk management must be the aim of everyone involved in a construction project. In other words, to identify patterns and potential problems, variations, hazards and risks in order to manage them effectively. This can only be achieved through the perfect preparation of each particular project. This is the theory.

However, in practice, the lowest bid price tends to be the most important criterion in public tender evaluations nowadays. This is also a reason why contracts (for works or for design) that determine particular project relations must anticipate and involve transparent, efficient and reasonable solutions to potential problems and complications.

### 1.3 Roles and relationships

In the course of time, five main groups of construction project participants have emerged as major players in the construction industry. These groups are directly involved in construction projects or have an influence or a particular function within the industry. They are the contractors, designers, regulators, employers and users (Murdoch and Hughes, 2008). Lenders (banks), insurance and reinsurance companies must also be mentioned as further (indirect) construction project participants because of their significant influence on construction projects. We will now discuss these important roles in the construction project.

#### 1.3.1 Contractors

Most frequently, contractors can be encountered as either global or local construction companies. Construction companies differ in specialization and size – from small contractors for specialized activities up to supranational organizations that enjoy major industrial and political influence.

In the field of large construction projects, contractors often collaborate within joint ventures, setting up delivery chains at numerous levels. A general contractor enters into relationships with the subcontractors who further delegate parts of their obligations down to other specialized trade contractors, and so on down