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Use and misuse of FIDIC Forms of Contract in Central and Eastern Europe: the worrying trend of Silver Book Provisions in public works contracts

by Frederic Gillion, Partner

Introduction

For over 40 years the EIC (European International Contractors) has been at the forefront of advocating fair and balanced conditions of contract in the international construction sector. Its on-going work of review of and comments on new editions of the FIDIC forms of Contract has certainly contributed to achieve this with the FIDIC 1999 Red (Conditions of Contract for Construction) and Yellow Books (Conditions of Contract for Plant and Design Build) and also the more recent 2008 Gold Book (Design, Build and Operate Projects).

At a time when the EIC's Working Group "Contract Conditions" is currently discussing the forthcoming second edition of the Yellow Book (as reported in the previous issue of the EIC Newsletter 2012/02) with the FIDIC Updates Task Group, it would seem that the biggest challenge faced by international contractors lies less in the improvements in the wording of the 1999 suite of FIDIC contracts than in its recent use in certain Central and Eastern European (CEE) countries where Employers have managed to impose in public works contracts – largely financed by the EU - very onerous provisions for the Contractor which radically change the allocation of risks established by the General Conditions of Contract.

This worrying trend was denounced by the EIC exactly a year ago in May 2011 in its statement issued jointly with the European Construction Industry Federation (FIEC) and addressed to the European Commission. In that joint statement, the EIC more particularly dealt with recent developments in Romania where new FIDIC conditions of contract introduced in March 2011 for road works contracts drastically modified the original FIDIC conditions of contract to the extent that one could no longer describe them as being either fair or balanced. Despite various lobbying initiatives towards the European Commission, it became apparent at the latest FIDIC International Users' Conference in London in December 2011 which concentrated on the use of FIDIC in Central Europe this recent trend has now spread in a number of other CEE countries (including Bulgaria, Poland, Hungary and Slovenia). The common theme stressed out by the speakers at that conference (including myself) was the increasing adoption of Silver Book provisions in Yellow Book contracts when FIDIC itself recognises that the Silver Book is only suitable in a specific context for EPC/Turnkey projects.

This article highlights some of the significant differences between the Yellow Book and the Silver Book, the provisions or principles of the Silver Book that are now being commonly adopted in public work contracts in certain CEE countries, and the additional risks that are as a result transferred to the Contractor, thus effectively removing FIDIC's traditional principles of balanced risk sharing.

Yellow Book / Silver Book: Key differences

The table below sets out the main features of the Yellow and Silver Books and highlight their key differences[1].

Key Issue	Yellow Book (Design-Build)	Silver Book (EPC/Turnkey projects)
Typical use	Recommended for the provision of electrical and/or mechanical plant and for building and engineering works if most (or all) of the works are to be designed by (or on behalf of) the Contractor.	Suitable for a process or power plant, a factory or similar facility, or an infrastructure project, or other type of development, if: • a higher degree of certainty of final price and time is required; and • the Contractor takes total responsibility for the design and execution of the project (including responsibility for Employer design).
Contract Administration	The Contract is administered by the Engineer (appointed by the Employer) who shall determine any claim for extension of time and additional payment, certify payments and issue taking-over and performance certificates.	No Engineer. The Contract is administered directly by the Employer or its representative who endeavours to reach agreement with the Contractor on each claim. The Introductory Note to the Silver Book emphasizes that if the Contractor is to achieve the certainly of time and price stipulated, then the involvement of the Employer must be limited to a minimum during construction.
General risk profile	Risks are allocated on a fair and equitable basis taking account of such matters as insurability, and each party's ability to foresee, and mitigate the effect of, the circumstances relevant to each risk. There are a number of key risks that the Employer retains, for example errors in the Setting Out data (Sub-Clause 4.7) Site data (Sub-Clause 4.10) and "Unforeseeable" Site risks (Sub-Clause 4.12). As a result, the tender time can be relatively short.	A majority of risks is allocated to the Contractor under the Contract, including any errors in the Setting Out Data (Sub-Clause 4.7), Site data (Sub-Clause 4.10) and unforeseeable difficulties or costs (Sub-Clause 4.12). The Contractor is expected to: • price these risks; and/or • carry out extensive due diligence to mitigate risks. A longer period for preparation of a tender is therefore usually required, in particular to inspect the Site and examine data hydrological and sub-surface data and also to scrutinise the Employer's Requirements (see Design below).

1. The FIDIC Contracts Guide (1st Edition, 2000), p.4.

Key Issue	Yellow Book (Design-Build)	Silver Book (EPC/Turnkey projects)
Design	The Contractor is responsible for design of the Works (sub-Clause 5.1), is required to design the Works in accordance with the Contract such that, when completed, the Works are fit for purpose (Sub-Clause 4.1) and gives an undertaking that the design will be in accordance with the documents forming part of the Contract, which include the Employer's Requirements (Sub-Clause 5.3).	
	The Contractor is not responsible for any error, fault or other defect found in the Employer's Requirements to the extent that "an experienced contractor exercising due care" would not have discovered the error, fault or defect before submitting its tender (Sub-Clause 5.1).	The Contractor is deemed to have scrutinised the Employer's Requirements and is responsible for the accuracy of the Employer's Requirements (including design criteria and calculations), except for the matters identified in sub-paragraphs (a) to (d) in Sub-Clause 5.1[2].
Contract Price and Payment	Lump sum price	
	The Employer will seek a lower tender price but is prepared to accept certain risks during the course of the project.	The Employer will typically accept the cost premium attached to the "turn key" approach, so as to limit its exposure to additional time/money claims.
	Interim and final payments are certified by the Engineer.	Interim and final payments are made without certification; typically determined by reference to a Schedule of Payments.
Contractor's rights to claim additional time / money	Various rights for the Contractor to claim additional time / money under the Contract, including in respect of those risks borne by the Employer in respect of errors in the Setting Out data (Sub-Clause 4.7), errors in the Site data (Sub-Clause 4.10) and unforeseen Site risks (Sub-Clause 4.12).	Limited rights for claim the Contractor to claim additional time / money under the Contract. Sub-Clause 8.4 [Extension of Time for Completion] does not include the right to an extension of time in the event of exceptionally adverse climatic conditions or unforeseeable shortages.

2 Those matters are:
"(a) portions, data and information which are stated in the Contract as being immutable or the responsibility of the Employer,
(b) definitions of intended purposes of the Works of any parts thereof,
(c) criteria for the testing and performance of the completed Works, and
(d) portions, data and information which cannot be verified by the Contractor except as otherwise stated in the Contract."

When are the Silver Book conditions of contract unsuitable?

When one compares the Silver Book with the Yellow Book, it is clear that the significant differences lie with the greater allocation of risks to the Contractor. Such an allocation of risk may be suitable when the Employer wants a greater degree of certainty in price and time and as long as it is prepared to pay a higher price in order to achieve that and to give the Contractor sufficient time at tender stage to examine the Employer's Requirements, to verify all relevant information and data and to make all necessary investigations so as to assess the severity of the risks it is taking.

Conscious that the Silver Book should therefore only be used for Design-Build projects where specific conditions are met, FIDIC makes clear in the Introductory Note to the Silver Book that these conditions of contract are not suitable in the following circumstances:

- 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 estimations (taking particular account of Sub-Clauses 4.12 [Unforeseeable Difficulties] and 5.1 [General Design Obligations]);
- If construction will involve substantial work underground or work in other areas which tenderers cannot inspect;
- If the Employer intends to supervise closely or control the Contractor's work, or to review most of the construction drawings;
- If the amount of each interim payment is to be determined by an official or other intermediary.

FIDIC then recommends that the Yellow Book be used in the above circumstances for Works designed by (or on behalf of) the Contractor. Prima facie, this is what many employers in the public sector in CEE countries have done but quite perversely they have sometimes altered the Yellow Books general conditions by adopting Silver Book provisions so as to obtain a greater certainty of price. Key risks placed on the Employer have as a result been transferred to the Contractor, thus effectively removing the fair and equitable allocation of risks under the Yellow Book. This is explained further below.

The adoption of Silver Book principles and provisions in public works contracts in CEE countries

Trend No. 1 / Contract Administration - The role of the Engineer reduced to being the Employer's Representative as in the Silver Book

The role of the Engineer under the Red and Yellow Books has always been the subject of much controversy due to the difficulty of reconciling the dual role of the Engineer as agent of the Employer and as decision-maker in respect of certain key matters under the Contract, including the determination of the Contractor's entitlement to additional payment and an extension of time, the instruction and valuation of variations and the issue of Payment Certificates, Taking-Over Certificate and Payment Certificates. Under the Red and Yellow Books, the Engineer is expected to exercise his sole discretion when deciding those matters and also to act fairly whenever they require a determination under Sub-Clause 3.5 (additional payment, extension of time and variations).

In practice, however, employers in the public sector in CEE countries have frequently sought to amend Sub-Clause 3.1 [Engineer's Duties and Authority] in order to restrict the Engineer's authority by requiring the Engineer to obtain the express approval of the Employer before deciding those key matters. For example this has been the case in Romania where over the past 4-5 years the government has gone even further by not only amending Sub-Clause 3.1 but also making that amendment compulsory for road works projects with the introduction of its new FIDIC-based General Conditions of Contract[3].

Although, in theory, the existence of that requirement alone does not necessarily mean that the Engineer will not make determinations fairly, there is of course a strong risk that the Employer may instruct the Engineer to withhold his determination or direct him to make a particular determination. If this happens, then the Engineer's role will in effect be limited to his role as an agent of the Employer and he will become no more than the Employer's Representative in the Silver Book who acts wholly for the benefit of the Employer, his principal.

The amendment introduced in Romania by the new FIDIC-based General Conditions of Contract to Sub-Clause 3.4 of the General Conditions of Contract [Replacement of the Engineer] seems to confirm that trend. The new Sub-Clause 3.4 has removed the Contractor's right to raise objections to the proposed appointment of a replacement Engineer. The Employer can now under the new General Conditions of Contract proceed with his appointment without even consulting the Contractor.

It is also frequent in certain CEE countries for employers in the public sector to request the issue of draft Interim Payment Certificates for their review / approval, thus effectively putting the Employer in a position of self-certifier.

Would those restrictions to the Engineer's authority really affect the administration of the contract? Putting aside FIDIC's policy which favours a fair and impartial Engineer for the good of the project as a whole, the answer to this question obviously depends on whether the Employer intends to deal promptly and fairly with the Contractor's claims for time and money, the financial impact of variations, etc. Ultimately, if the Employer were to instruct the Engineer to withhold his determination or to instruct him to make a particular determination, then the Employer would be in breach of its undertaking under Sub-Clause 3.1 not to place any further constraints on the authority of the Engineer. The Contractor may also be able to rely on Sub-Clause 1.3 [Communications] which provides that any "Approvals, certificates, consents and determinations shall not be unreasonably withheld or delayed."

Trend No. 2 - Extra risks borne by the Contractor under the Silver Book are now frequently being transferred to the Contractor in D&B projects where the Silver Book is not suitable

More importantly, in some CEE countries such as Poland and Romania, key risks borne by the Contractor under the Silver Book are now being allocated to the Contractor even in Design and Build projects where the Silver Book is not suitable. Those risks include errors in the Setting Out data (Sub-Clause 4.7) inaccurate or incomplete Site data (Sub-Clause 4.10), Unforeseeable physical conditions (Sub-Clause 4.12) and errors in the Employer's Requirements (Sub-Clause 5.1).

3. These new FIDIC-based General Conditions of Contract applicable to road works were introduced in March 2011 by Romanian Government Order No. 146. See the EIC's analysis of the Romanian Particular Contract Conditions under the section "Working Group Contract Conditions Advances Lobbying Strategy for Romania" in the EIC Newsletter No.2/2012.

Errors in the Setting Out data (Sub-Clauses 4.7 YB/SB), Sub-Clause 4.7 of the Yellow Book

The Contractor is entitled (subject to Sub-Clause 20.1) to time and cost plus profit from executing work which was necessitated by an error in the setting-out data, which an experienced contractor could not reasonably have discovered. This is in contrast with the Silver Book where the Contractor takes responsibility for any errors in the setting out data contained within the Employer's Requirements (Sub-Clause 5.1 of the Silver Book deems the Contractor responsible for the accuracy of the Employer's Requirements with certain limited exceptions). The Contractor therefore retains under the Silver Book the risk arising from errors in setting-out.

A usual criticism of EU-financed projects in CEE countries has been that the Employer's Requirements lack in precision, often because the Employer rushes to launch new tenders in order to absorb the relevant EU funds. Unreliable tender documents have sometimes resulted in significant errors in setting-out, which could lead to significant delays at the outset of the project.

In order to avoid claims from contractors resulting from errors in setting-out, the Romanian Government has essentially adopted the approach of the Silver Book by retaining only the first paragraph of Sub-Clause 4.7 and deleting the rest of that sub-clause in the new FIDIC General Conditions of Contract (Yellow Book) applicable to road works. It follows that the Contractor is now required to rectify any error in the setting-out data provided by the Employer and the Engineer but is not entitled to make any claim in this connection. Also, as it is explained below, those new FIDIC General Conditions of Contract have introduced a significant amendment to Sub-Clause 5.1 to the effect that the Contractor becomes responsible for the accuracy of the Employer's Requirements as in the Silver Book.

Inaccurate or incomplete Site data (Sub-Clauses 4.10 YB/SB)

Under Sub-Clause 4.10 of both the Yellow Book and the Silver Book, the Employer is required to make available to the Contractor all relevant data in the Employer's possession on sub-surface and hydrological conditions on the Site and is under a continuing obligation to make available to the Contractor all such data which come into the Employer's possession after the Base Date (i.e 28 days prior to the latest date submission of the Tender).

As this obligation can potentially be quite far-reaching for the Employer, some employers in CEE countries have sought either to expressly exclude (subject to certain limited exceptions in Sub-Clause 5.1) the Employer's responsibility for the accuracy or completeness of such data as in the Silver Book, or to insert a wording limiting that obligation to the tender stage and expressly excluding the Contractor's right to claim for an extension of time and / or additional payment in the event of inaccurate or incomplete information.

Unforeseeable physical conditions (Sub-Clause 4.12)

Adverse physical conditions unforeseen at tender stage have been a common cause of delay and disputes in EU-financed projects in CEE countries. The reason for this has again often been due to the lack of project preparation before a tender is launched leading to discrepancies between the geological and hydrological conditions anticipated at tender stage and the actual Site conditions.

Again, the FIDIC Yellow and Silver Books provide again two radically different approaches. As seen above, whilst that risk is borne by the Employer under the Yellow Book to the extent that such physical conditions could not reasonably be foreseeable by an experienced contractor by the date for submission of the Tender, the Silver Book generally places that risk on the Contractor.

Under the Silver Book, the Contractor is deemed to have obtained all necessary information to assess risks and circumstances which may influence or affect the Works (Sub-Clause 4.12(a)); considered all such information and accepts total responsibility for having foreseen all difficulties (Sub-Clause 4.12(b)), and should have allowed, within its Tender, sufficient time and funds to carry out the Works (Sub-Clause 4.12(c) providing that "the Contract Price shall not be adjusted to take account of any unforeseen difficulties or costs").

It is therefore not surprising that some employers in CEE countries have sought to include Silver Book provisions in Yellow Book contracts. The most extreme example is again in Romania where the wording of the Silver Book has literally replaced Sub-Clause 4.7 of the Yellow Book for those public work contracts in the road sector. Given the nature of the work involved, allocating the risk of unforeseen ground conditions to the Contractor appears to be totally inappropriate as FIDIC itself recognises in its "Introduction to the use of FIDIC's conditions of Contract."[4] This is even more so when, as it is often the case, there is insufficient time or information for tenderers to carry out their own investigations.

Errors in the Employer's Requirements (Sub-Clauses 1.9 YB and 5.1)

Errors in the Employer's Requirements have also been a frequent cause of claims pursuant to Sub-Clause 1.9 of the Yellow Book due to the lack of project preparation before the launch of tenders in CEE countries and the resulting lack of precision of the Employer's Requirements.

Instead of tackling this issue by improving the quality of the project documentation, sometimes employers have simply chosen to adopt the regime of design responsibility of the Silver Book by allocating that risk to the Contractor. The problem is that they did so without allowing sufficient time at tender stage for the Contractor to scrutinise the Employer's Requirements and certainly without accepting the cost premium attached to this significant risk.

In Romania, the situation went even further with the adoption of the new FIDIC-based Conditions of Contract applicable to road works. The new Sub-Clause 5.1 not only adopts the wording of the Silver Book in terms of the Contractor's responsibility for the Employer's Requirements, but it also restricts the number of exceptions only to those matters stated in sub-paragraphs (a) to (c) of Sub-Clause 5.1. Sub-paragraph (d) which excludes the Contractor's responsibility for "portions, data and information which cannot be verified by the Contractor except as otherwise stated in the Contract" has been omitted from that new Sub-Clause 5.1, therefore creating an even more onerous design obligation for the Contractor than in the Silver Book.

Trend No. 3 - Restriction of the Contractor's right to claim additional time / money in respect of risks traditionally borne by the Employer under the Silver Book

Admittedly, in some CEE Countries the Employer's clear objective to obtain a higher degree of certainty of price and construction time can be understood given that most

4. The FIDIC Contracts Guide (First Edition 2000), p.8: "if underground works in uncertain or difficult ground conditions are likely, the risk of unforeseen ground conditions should be borne by the Employer and P&DB 4.12 would be appropriate."

public works projects in those countries rely for a very large part on EU financing and that very limited funds exist in the State budget to finance these projects.

However, some CEE countries may have taken that objective which underlies the Silver Book a step too far by restricting the Contractor's rights to claim additional time and money in respect of risks which are traditionally borne by the Employer, even under the Silver Book.

Those matters which clearly fall within the Employer's responsibility in public works projects include for example access to the Site (Sub-Clause 2.1) and changes in legislation (Sub-Clause 13.7).

Lack of possession of / access to the Site has in most CEE countries been one of the main causes of delays to public infrastructure projects due to the lengthy expropriation procedures in place in those countries. Although new legislation has been passed in recent years to simplify and speed up the procedure for the compulsory acquisition of land for State infrastructure projects, this problem remains a significant one.

In order to restrict the Contractor's right to claim additional time and money pursuant to Sub-Clause 2.1, some employers have sought to amend this sub-clause by limiting that obligation to the land already owned by the Employer at the Commencement Date. New contracts of road works in Romania now allow the Employer to give the Contractor access to the Site gradually in sections whilst requiring the Contractor to adjust its Programme of Works to reflect this sectional completion of the Works. The Contractor also waives any right to claim in respect of the handing over of the Site in sections, irrespective of the size of those sections, their location, or the additional costs associated with a completion of the Works in sections.

As for the Contractor's right to claim time and costs as a result of ***changes in legislation***, such right sometimes excludes VAT increases, for example in Poland or in Slovenia.

"Trend No. 4" – Cap on adjustments to the Contract Price

In order to obtain almost a guarantee of certainty with the Contract Price, the Romanian Government went as far as including a cap on any adjustment to the Contract Price, save for adjustments resulting from changes in legislation under Sub-Clause 13.7 and changes in costs under Sub-Clause 13.8 (if the contract include a price escalation mechanism).

In the new Romanian FIDIC-based General Conditions of Contract (Yellow Book), Sub-Clause 14.1 [The Contract Price] now provides that the Contract Price shall not be increased by more than 10% of the Accepted Contract Amount, meaning that any payment of variations instructed by the Engineer will be capped to that level. This obviously represents a significant financial risk for the Contractor even though the applicable law may offer a basis for payment of any varied works where its value exceeds 10 % of the Accepted Contract Amount. Luckily, such a cap on adjustments to the Contract Price does not seem to be common in other CEE countries and will hopefully not be a trend as such.

Conclusion

Due to its far-reaching effects for contractors, the new FIDIC-based General Conditions of Contract introduced by the Romanian Government in March 2011 for road works projects have become an important casus belli for the EIC and international contractors operating in Romania.

However, beyond Romania, there is undoubtedly a growing trend in the region for significant risks traditionally borne by employers under the FIDIC Yellow Book to be transferred to contractors in public works projects, often by importing provisions or principles from the Silver Book.

Such a trend calls for a rapid change in EU secondary legislation so as to ensure that EU-financed contracts do reflect FIDIC's principles of balanced risk sharing.

Frederic Gillion, Partner
Fenwick Elliott
+44 (0)207 421 1986
fgillion@fenwickelliott.com